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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

THE POSITION OF THE WORLD ECONOMY ON THE EVE OF THE OUTBREAK OF THE KOREAN WAR AND THE POST-KOREAN DEVELOPMENTS AND PROSPECTS

PART II. POST-KOREAN DEVELOPMENTS AND PROSPECTS
B. THE UNITED KINGDOM

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Economic Staff
Prepared by: K. Varvaressos
R. Zafiriou

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A. THE STRENGTH OF BRITAIN'S ECONOMIC POSITION IN THE FIRST POST-KOREAN YEAR JULY 1950-JUNE 1951

In the first part of this Memorandum we argued that the strength displayed by the British economy during the six months preceding the outbreak of the Korean war concealed serious weaknesses which were bound to make themselves felt at a later date even if there had been no Korea. Externally, during the first half of 1950 Britain achieved an overall surplus in her current account of £ 84 million (annual rate) and increased her dollar reserves by $734 million. The capital account, which since the end of the war had been a serious drain on Britain's resources, for the first time showed a net surplus of receipts over payments. Internally, financial stability had been maintained in spite of the drastic devaluation of sterling in September 1949 and production had expanded considerably: In June 1950 the index of retail prices was only 1.8 percent higher than in September 1949, while the index of wage rates showed a rise of only 0.9 percent. Wholesale prices had risen by 11 percent and export prices by 5 percent, at which level they were more than competitive in world markets. Industrial production during the first half of 1950 increased by 8 percent compared with the corresponding period of 1949 due mainly to higher output per man, and there was also a substantial increase in the output of meat and dairy products.

The conclusion, however, which was widely drawn from these gains, namely, that Britain's economic difficulties had been solved, was premature for the following reasons which we pointed out in the first part of this Memorandum:

(a) Imports were still substantially below pre-war and were maintained at that level only through very severe restrictions and through the depletion of stocks. An increase of imports to their pre-war volume would have been sufficient to convert the current account surplus into a deficit. (b) A considerable part of the improvement in the dollar position was due to a return of flight capital, which was a non-recurring resource. Another important part was due to intensified restrictions against dollar imports by other sterling area countries. These restrictions, however, were not likely to be maintained in view of the improvement in the dollar position of the individual countries in the group. Finally, of the $735 million increase in the gold and dollar reserve which took place during the first half of 1950, $515 million were due to the receipt of American and Canadian aid. (c) The net surplus on capital account concealed considerable releases of sterling balances and exports of capital to certain countries offset by very large accumulations of sterling by other countries and especially Australia and the colonies. We pointed out in the first part of this Memorandum that such accumulations of sterling by one group of countries could not continue indefinitely, while the tendency to make large releases of sterling to other countries and to export capital remained and was again bound to prove an unfavorable factor in the British external position as soon as the accumulation of sterling by countries like Australia was arrested or reversed. (d) With regard to internal conditions, we pointed out that further increases in prices and costs appeared inevitable since there was a strong pressure for wage increases and since the rise in raw material prices had not yet been re-

flected in the prices of finished goods. Similarly, inflationary pressures, although reduced, were still present and physical controls and restrictions were still necessary. Finally, no further great expansion in production appeared likely.

Our overall conclusion on the position of the British economy at the time of Korea was as follows: "The progress made by the British economy in 1950 was spectacular but it still fell short of complete recovery. Britain had succeeded in restoring a considerable degree of balance in its economy but that balance was still a precarious one and depended as much on controls and restrictions and on the public spirit of the population as on purely economic forces. It is probable that several more years of sustained effort would have been required before the country had completely adjusted itself to the changed conditions, internal and external, of the post-war period." It also followed from this conclusion that the increased military expenditures decided upon after Korea were bound to impose a very severe strain on the British economy.

Developments during the first post-Korean year seemed to suggest that this interpretation of the British economic situation had been unduly pessimistic.

I. - The External Position during July 1950-June 1951

During July-December 1950 the British balance of payments showed further considerable improvement and the gold and dollar reserve increased by another $878 million, while the internal economic situation remained good. During January-June 1951 the rise in the value of imports resulted in some

deterioration in Britain's external accounts but the overall position was still strong and there was a further increase of $567 million in the gold and dollar reserve. Internally, the rise in import prices and a relaxation of economic discipline were pushing prices upwards at a faster rate than in the rest of the world, but the effects on the country's overall economic position had not yet been felt.

External economic developments in the first post-Korean year are summarized in the following table:

Overall Current Account
(Million £)

	1950 1st Half	1950 2nd Half	1951 1st Half
Receipts			
Exports	1,040	1,183	1,310
Other	428	492	598
Total	1,468	1,675	1,908
Payments			
Imports	1,165	1,217	1,646
Other	261	279	333
Total	1,426	1,496	1,979
Net Balance	+ 42	+ 179	- 71

Overall Capital Account
(Million £)

	1950 1st Half	1950 2nd Half	1951 1st Half
Investment (-) or borrowing (+)	- 25	+ 23	- 163
Sterling balances: Net increase (+) or decrease (-)	+ 134	+ 84	+ 404
Net export (-) or import (+) of capital	+ 109	+ 107	+ 241
Grants	+ 111	+ 28	+ 33
Total net receipts (+) or payments (-) on capital account	+ 220	+ 135	+ 274

This table shows that the continued strength of Britain's overall external position in the first post-Korean year was due to two factors, increased invisible earnings and very large accumulations of sterling balances. Net invisible earnings during the period July 1950-June 1951 increased by £ 144 million compared with the first half of 1950 (annual rate), almost exactly offsetting the increase in the trade deficit resulting from the higher value and volume of imports. Similarly, there was an increase of £220 million in the accumulation of sterling balances compared with the first half of 1950 (annual rate) which offset the increase in capital exports and the decline in foreign grants that took place during that period. Both factors were connected with the very sharp rise in the prices of sterling area primary products which occurred after Korea,[1/] and as such, were bound to prove temporary and, in the case of sterling accumulations, actually to reverse themselves. A third factor which, however, was not independent but resulted from the strength exhibited by sterling during that period was the expectation of revaluation which led to a considerable speculative demand for sterling in foreign markets.

Estimates of the overall British balance of payments are of limited significance in assessing the real British external position since they conceal the existence of large surpluses in certain currencies and

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1/ Of the total increase of £144 million in net invisible earnings between the first half of 1950 (annual rate) and the first post-Korean year July 1950-June 1951, £130 million represented an increase in net invisible earnings from the rest of the sterling area, mainly investment income and shipping.

large deficits in other currencies which do not cancel out but require offsetting movements in the capital account. A breakdown of the British balance of payments by major currencies or areas during the period under consideration reveals more clearly the precarious nature of Britain's external strength during that period.

1 - The Dollar Area

The increase in Britain's dollar reserves was due almost exclusively to the dollar surplus of the sterling area and to speculative capital movements. This may be seen in the following table which summarizes the British balance of payments position with the dollar area in 1950 and in the first half of 1951:

Million £

Current Account

	1950 1st Half	1950 2nd Half	1951 1st Half
Receipts			
Exports	133	183	188
Other	58	38	65
Total	191	221	253
Payments			
Imports	203	226	304
Other	44	46	62
Total	247	272	366
Net Balance	- 56	-51	-113

Capital Account

Receipts			
American grants	152	96	44
Defense aid	-	-	3
Dollar surplus of rest of sterling area:			
(a) Dependent territories	54	80	117
(b) Independent countries	9	11	38
Purchase of gold from rest of sterling area	53	47	41
Receipts of gold and dollars from other areas	-	2	48
Liquidation of dollar investments	15	14	11
Increase in sterling liabilities towards dollar area	1	47	-
Government borrowing	20	-	5
Other imports of capital	32	85	26
Other	12	8	6
Total	348	390	339
Payments			
Repayment of dollar loans	17	20	14
Other	13	5	9
Total	30	25	23
Net Balance	+ 318	+ 365	+ 316

Increase in Gold and Dollar Reserves

Net balance on capital account less deficit on current account	262	314	203

The preceding table shows that three items in the capital account; namely, the dollar surplus of the rest of the sterling area, the receipts of gold and dollars from other areas and other imports of capital account for a large part of the increase in Britain's reserves during the period under consideration. Of these three items, the last two represented to a considerable extent speculative capital movements and were not, therefore, a dependable source of dollars for the British balance of payments. Similarly, the dollar surplus of the independent countries of the sterling area was the product of the exceptional circumstances of 1950-51 rather than a characteristic feature of the area's balance of payments structure. Most of the sharp cuts in dollar imports decided upon by these countries before devaluation were still in operation in 1950 and in the first part of 1951 at a time when dollar earnings from the sale of primary products to the United States were abnormally high as a result of the fantastic post-Korean rise in the prices of these products. It is clear that a relaxation of import restrictions and a return of prices to more normal levels would have wiped out the dollar surplus of the independent countries of the sterling area. The dependent territories have been steady contributors of dollars to the British balance of payments, but judging from the experience of earlier years, the contribution of these territories to Britain's dollar resources was unlikely to exceed £100 million per annum in a normal year compared with £197 million in the first post-Korean year.[1/]

While Britain's dollar earnings were thus deceptively large in 1950-51, her dollar expenditures during that period were below normal as a

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1/ See next page (page 9) for footnote.

result of the maintenance of very severe restrictions on dollar imports and of the running down of stocks.[2/] Moreover, the servicing of the American loan, which was to require £62 million per annum, was only due to begin in the second half of 1951.

1/ (from page 8)

Trade of Rest of Sterling Area with Dollar Area
(Million Dollars)

	Dependent Territories	Independent Sterling Area Countries
	Exports	
1948	490	635
1949	385	510
1950	500	710
1st half 1951	405	640
2nd half 1951	240	365
1st half 1952	290	405
	Imports	
1948	315	845
1949	220	805
1950	130	590
1st half 1951	85	450
2nd half 1951	125	700
1st half 1952	120	700
	Trade Balance	
1948	+175	- 210
1949	+165	- 295
1950	+370	+ 120
1st half 1951	+320	+ 190
2nd half 1951	+115	- 335
1st half 1952	+170	- 295

2/ British imports from the dollar area have been as follows since 1948:

	1948	1949	1950	1st Half 1951	2nd Half 1951	1st Half 1952
	(Million Dollars)					
Foodstuffs	569	615	451	322	340	322
Tobacco	87	93	97	21	146	15
Raw materials	561	545	400	327	471	469
Petroleum	183	160	130	95	152	92
Machinery and vehicles	166	145	101	72	69	82
Other	63	46	24	14	20	18
Total	1,629	1,604	1,203	851	1,197	998

Taking all these considerations into account we may conclude that Britain's dollar surplus in 1950-51 was a temporary phenomenon which created an erroneous impression about the real British external position.

If one attempted to determine what the British dollar accounts would have been in 1950-51 in the absence of the exceptional circumstances mentioned above, one would probably find that instead of a £500 million surplus with the dollar area there would have been a deficit of the order of over £50 million:

Million £
July 1950 - June 1951

	Normal	Actual
Current Account		
Imports	-580	-530
Exports	+380	+371
Trade Balance	-200	-159
Balance of invisibles	-	- 3
Current account deficit	-200	-162
Capital Account		
Receipts		
American grants	-	140
Dollar surplus of dependent territories	100	197
Dollar surplus of independent countries of sterling area	-	49
Purchases of gold from sterling area	80	88
Receipts of gold and dollars from other areas	-	50
Liquidation of dollar investments	-	25
Increase in sterling liabilities to dollar area	-	47
Miscellaneous imports of capital	25	112
Other	10	14
Total	215	722
Payments		
Repayment of dollar loans	35	34
Dollar deficit of independent sterling area countries	25	-
Dollar payments to other areas	10	-
Other	10	14
Total	80	48
Net Balance on capital account	+ 135	+ 674
Increase in gold and dollar reserves	- 65	+ 512

Adding the £62 million annual payments for the servicing of the American and Canadian loans, we may conclude that the prospects after 1951 were for a dollar deficit of over £100 million per annum which could have been avoided only by a severe cut in British dollar imports. This is an entirely different picture from that suggested by the plethora of dollars experienced in 1950-51.

2 - The Sterling Area

We have seen that the strength of Britain's position vis-a-vis the dollar area in 1950-51 was due in large part to the fact that sterling area countries turned in their dollars against sterling instead of spending them on dollar goods. Britain's position vis-a-vis the sterling area during that period is characterized by the fact that the sterling thus acquired by the sterling area countries was allowed to accumulate in London rather than be used for purchases of British goods. The following table shows that Britain's current account surplus with the sterling area was barely sufficient to finance her exports of capital to the area and the purchase of newly-mined gold from the area. The payments made for the dollars and other currencies obtained from the sterling area and other areas were wholly offset by an increase in sterling liabilities i.e., by an increase in Britain's short-term sterling debt:

Million £

Current Account

	1950 1st Half	1950 2nd Half	1951 1st Half
Receipts			
Exports	467	528	581
Other	190	231	300
Total	657	759	881
Payments			
Imports	457	500	654
Other	117	124	139
Total	574	624	793
Net Balance	+ 83	+ 135	+ 88

Capital Account

Receipts			
Increase in sterling liabilities	217	161	368
Payments			
Purchases of gold from sterling area	53	47	41
Purchases of dollars from sterling area	63	91	155
Purchases of other currencies from sterling area	114	94	170
Exports of capital	70	64	90
Total	300	296	456
Net Balance	- 83	-135	- 88

It should be noted that the increase in sterling liabilities shown in the preceding table is a net figure which conceals large releases of sterling to certain countries and large accumulations by other countries. The significance of this, as already stated, is that while sizeable annual releases of sterling are part of a settled British policy and, therefore, a regular burden on the British balance of payments, large accumulations of sterling by other sterling area countries or territories cannot be considered as anything but a temporary feature of the balance of payments. This means that Britain's position in relation to the sterling area in 1950-51 was built on a highly precarious basis. If there had been no

accumulation of sterling by certain countries Britain would have been able to balance her accounts with the sterling area only through an increase in her exports to the area or a reduction of her imports from the area by some £300 million, i.e., by about 50 percent. This is the measure of the disequilibrium underlying the relationship between Britain and the rest of the sterling are in 1950-51.

3 - The OEEC Countries

Another source of strength in Britain's balance of payments position in 1950-51 was its surplus with OEEC countries to the extent that it resulted in an accretion of gold and dollars. (The part of the surplus which was financed through British credits to OEEC countries was a burden and not a gain for Britain.) Again, however, this was a surplus which was likely to prove temporary. In 1949, the British current account with OEEC countries was in approximate balance, but there was a heavy outflow of capital which resulted in considerable gold and dollar payments and in a large increase in short-term debt. The improvement which occurred during the first half of 1950 was due mainly to the following three developments which are shown in the accompanying table: (a) British exports to OEEC countries increased more than British imports from the area, (b) other British receipts also increased very considerably (probably reflecting in part a reversal of capital flight) and, (c) the rest of the sterling area which in 1949 had a substantial deficit with the OEEC countries developed a large surplus with these countries mainly as a result of the increase in the demand and prices of sterling area primary products. These factors continued to operate in the second half of 1950, but the sharp increase in

British imports from OEEC countries following trade liberalization turned the British current account surplus into a deficit. This however, was more than offset by the large surplus earned by the rest of the sterling area in its trade with OEEC countries:

Current Account
(Million £)

	1949	1950 1st Half	1950 2nd Half	1951 1st Half
Receipts				
Exports	420	286	308	365
Other	158	99	134	134
Total	578	385	496	499
Payments				
Imports	457	272	300	435
Other	125	60	73	90
Total	582	332	373	525
Net Balance	- 4	+ 53	+ 69	- 26

Capital Account
(Million £)

Receipts				
Transfers of OEEC currencies from other areas	-	49	65	95
Transfers of gold and dollars to OEEC countries	39	2	5	-
Repayment of Government loans	4	10	17	6
Increase in sterling liabilities to OEEC countries	69	-	4	27
Decrease in official holdings of OEEC currencies	15	-	-	23
Other	5	3	1	1
Total	132	64	92	152
Payments				
Acquisition of gold and dollars from OEEC countries	-	-	-	37
Government lending to OEEC countries	-	-	-	22
Other capital exports to OEEC countries	20	19	6	33
Increase in credits or decrease in debits with EPU	-	-	80	34
Decrease in sterling liabilities to OEEC countries	-	48	-	-
Increase in official holdings of OEEC currencies	-	18	10	-
Credits under Intra-European Payments Agreement	46	31	65	-
Sterling revaluation payments	34	1	-	-
Transfer of OEEC currencies to other areas	28	-	-	-
Total	128	117	161	126
Net Balance	+ 4	- 53	- 69	+ 26

The preceding table shows that in the first half of 1951 Britain had a current account deficit with the OEEC countries and in addition was transferring large sums of sterling to them on capital account. The continued strength of her overall position vis-a-vis the group was due mainly to the surplus of the rest of the sterling area with the OEEC countries (£95 million). This surplus, however, was largely the result of the boom in primary products which followed the outbreak of the Korean war and of the fact that sterling area countries had been slow in relaxing their import restrictions in response to their inflated home demand and their stronger external position. It was not, therefore, a factor on which Britain could permanently count to offset her own deficit and her large transfers of funds to OEEC countries.

4 - Western Hemisphere other than Dollar Area

A final disturbing feature of the British external position during that period was the low volume of trade with Latin America, i.e. with the region which could supply Britain with many of the primary products needed by her economy and which could absorb large quantities of British exports. The following table shows that in 1950-51, when the value of overall British imports increased considerably, the value of British imports from Latin America actually declined and there was no expansion in British exports to the area:

Million £

Current Account

	1950 1st Half	1950 2nd Half	1951 1st Half
Receipts			
Exports	53	56	57
Other	44	38	43
Total	97	94	100
Payments			
Imports	103	57	74
Other	4	3	4
Total	107	60	78
Net Balance	- 10	+ 34	+ 22

Capital Account

Receipts			
Increase in sterling liabilities	8	-	10
Sales of investments	6	26	4
Other	2	-	-
Total	16	26	14
Payments			
Decrease in sterling liabilities	-	43	-
Revaluation payments	2	-	11
Sterling drawings on I.M.F.	-	-	10
Exports of capital	-	6	11
Other	4	11	4
Total	6	60	36
Net Balance	+ 10	- 34	- 22

Our conclusion from the preceding examination is that Britain's external strength in 1950-51 was deceptive because it was based on three wholly temporary factors, namely (a) continued severe restrictions on British imports and running down of stocks, (b) exceptionally large foreign exchange earnings by other countries of the sterling area, (c) accumulation of a large part of these earnings in London in the form of sterling balances due to the delay in utilizing them for the financing of larger imports.

II. The Internal Position during July 1950-June 1951

A similar conclusion holds with regard to the internal British situation during that period.

The progress made during the first half of 1950 was maintained in the first post-Korean year. Industrial production, which had increased by 8 percent between the first half of 1949 and the first half of 1950, expanded by another 4 percent in the first half of 1951. Agricultural production increased by 6 percent over 1949. Retail prices, which had risen by only 2 percent during the first half of 1950, rose by another 4 percent between July 1950 and March 1951. In the same period retail prices in the United States increased by 7 percent. Similarly, wage rates rose less in Britain than in the United States during that period (by 6 percent as compared with 8 percent in the United States).

That 1950 and the first months of 1951 were a period of internal stabilization is also shown by the fact that during that period there was a considerable improvement in Government finances and only a moderate increase in bank credit. During the fiscal year April 1950-March 1951 the overall budget surplus totalled £250 million compared with £62 million in

1949-1950. 1/

1/ The British budget accounts are divided into two categories, "above-the-line" accounts and "below-the-line" accounts. The former include the ordinary receipts and expenditures of the Government, the latter include principally loans and other non-revenue items. Comparing 1950-51 with 1949-50 we find that there was both an increase in revenue and a decline in expenditures between the two periods:

	1949-50 (Million £)	1950-51 (Million £)
Receipts		
1-Above-the-line		
Taxes	3,687	3,730
Other	237	248
Total	3,924	3,978
2-Below-the-line		
Total	66	73
Expenditures		
1-Above-the-line		
Defense	741*	777*
Other	2,634	2,481
Total	3,375	3,258
2-Below-the-line		
War damage	173	94
Loans to local authorities	272	313
Other	108	136
Total	553	543
Net Balance		
1-Above-the-line	+ 549	+ 720
2-Below-the-line	- 487	- 470
3-Overall	+ 62	+ 250

The decline in expenditures was due primarily to the fact that in 1950-51 Government trading stocks declined by £108 million while in 1949-50 they had increased by £26 million.

*Estimates of defense expenditures contained in the Economic Survey for 1952 show higher expenditures for 1950-51 because they include spending on productive facilities which in the Budget are included in below-the line expenditures. The estimates of the Economic Survey are as follows:

	Million £ Defense Expenditure	
	1949-50	1950-51
Pay of forces	198	210
Production	274	345
Other	272	275
Total	744	830

Bank loans, which had expanded by 11 percent in 1949, increased by only 7.5 percent in 1950. This better financial picture, combined with the 4 percent increase in industrial production mentioned above, helped to maintain internal equilibrium in spite of the increase in consumption which took place in 1950 and of the fact, which was clearly inflationary, that the large external deficit of 1949 had been converted into a large surplus in 1950.

There were, however, four elements in the picture which indicated that the equilibrium achieved would not be maintained:

(a) Since 1948 the pressure for wage increases, generated by the strong bargaining position of labor under conditions of full employment, had been held in check by means of Governmental exhortations for restraint and by the slowness, partly deliberate, of the machinery for the settlement of wage claims.[1/] These, however, were expedients which could not be counted upon indefinitely to maintain wage stability under conditions of labor scarcity. The rise in the cost of living, which the increase in the prices of primary products following Korea made inevitable, were bound to give additional impetus to the pressure for wage increases.

(b) Retail prices had been slow to reflect the increased cost of materials. Thus, while, as already stated, the index of retail prices rose by

1/ See The Economist, November 4, 1950, p. 677: "Many trade unions have made considerable claims all along. The restraint is in the way they have been handled. Employers and arbitration tribunals have been encouraged by the Government's attitude either to refuse the claims or to grant much less than the usual 50 percent of what unions asked. The union's restraint - and it is real enough - has been to accept with fairly good grace the slowness of the negotiations on their claims and the smallness of the results. This policy has worked well. Its weakness is that of all Government by postponement. It requires an increasing effort to produce a constant result. For some time the administrative apparatus of delay for wage claims can make the number of advances granted very small. But as more and more claims accumulate in the pipelines of bargaining and arbitration, the number coming out as, at any rate, small advances must increase again even though each individual claim is subject to as much delay as ever."

only 4 percent between July 1950 and March 1951, the index of wholesale prices during the same period rose by 20 percent. Part of this rise in raw material prices was speculative and was, therefore, likely to prove temporary, but most of it was a permanent development of the world price structure and was, therefore, bound to raise the cost of British manufactures at a later date.

(c) The large annual increases in industrial production achieved in post-war years, although widely expected to continue, were unlikely to do so after the obstacles and bottlenecks in production had been eliminated and labor productivity had been restored to a level consistent with the technical equipment and attitude to work existing in British industry. Moreover, since British industry was producing for world markets to a far greater extent than American industry and since world demand for industrial goods had changed markedly compared with pre-war, it was to be expected that once the abnormal post-war demand for goods had been satisfied an important segment of British industry, i.e. the consumer goods industries, would be faced with a stationary, if not shrinking, foreign demand for their goods.

(d) The impact of the three-year rearmament program, which was announced by the British Government in July 1950 and which contemplated an increase of nearly 10 percent in total Government expenditures, 1/ had not yet been felt

1/ See The Economist, August 12, 1950, p. 325: The program which was outlined in a Government memorandum contemplated a total spending of £3,400 million for defense purposes over a three-year period. It was stated, however, that this figure was an "upper limit" and that it depended on the extent of American assistance in the form of materials, plant and free dollars. Since defense spending had been £741 million in 1949-50, the new program implied an average increase in defense spending of some £390 million or 50 percent. In January 1951 an expanded program was announced by the Government involving expenditures of £4,700 million over the three years beginning April 1951 to be spread as follows:

1951-52	£1,300 million
1952-53	£1,600 million
1953-54	£1,800 million

(See The Economist, February 24, 1951, p. 444-445).

by the British economy. As already stated, Government expenditures in 1950-51 were lower than in the previous year. Military expenditures, which totalled £741 million in 1949-50, increased to £777 million in 1950-51, or if capital expenditures are taken into account, to £830 million,[1/] but this increase in military expenditures was more than offset by decreases in other expenditures.

(e) The deterioration in the terms of trade which took place after Korea as a result of the rise in import prices was bound to impose an additional burden on the already over-extended British economy and hence to add to the internal strain. Since, however, many of the imports arriving in Britain in the first post-Korean year had been contracted for at pre-Korean prices, the effect of the deterioration of the terms of trade on British resources was slow in making itself felt in the economy. Thus, it was not until the second quarter of 1951 that the discrepancy between the rise in import prices and the rise in export prices reached its peak: in December 1950 import prices had risen by 7 percent more than export prices compared with July 1950, but in May 1951 the discrepancy had increased to 20 percent.

In the light of the preceding considerations, it seemed reasonable to conclude that further increases in production could not be counted upon to provide additional resources for rearmament and for the payment of needed imports and that consequently, a renewal of inflation and/or a deterioration in the external position were inevitable unless cuts in consumption and investment made available the additional resources required for the above purposes. These considerations also suggested that, unlike the United States, where the high productivity of the economy made it relatively easy to bring inflation under control and to arrest the rise in prices, Britain was faced with the prospect of a steady upward pressure of prices which could once again impair the competitiveness of British products in foreign markets.

1/ See footnote p. 18.

These signs of coming strain were, however, disregarded and instead of the tightening up of consumption and investment which the British situation required, there was a considerable relaxation of economic discipline based on the view that Britain was at last out of the woods.

Bank credit was allowed to expand rapidly, rising from £1,644 million to £1,931 million during 1951, i.e. by 16.3 percent. During 1950, as already stated, the increase had been only 7.5 percent.

Similarly, no serious effort was made to offset the rising military expenditures either through cuts in other expenditures or through increases in taxation.

Thus, during fiscal year April 1951-March 1952 military expenditures increased by £335 million, and there was also a large increase (£550 million) in other expenditures,[1/] but revenue increased by only £476 million. The result was that the earlier budget surplus was, for the first time since 1947, converted into a deficit:

1/ The main factors in the increase in other expenditures were the building up of trading stocks and the stockpiling of strategic reserves. These accounted for £203 million in 1951-52, while in 1950-51 there was a net decline in stocks of £95 million.

	1950-51	1951-52[1]
	(Million £)	
Receipts		
1-Above-the-line		
Taxes	3,730	4,190
Other	248	250
Total	3,978	4,440
2-Below-the-line		
Total	73	87
Expenditures		
1-Above-the-line		
Defense	777	1,112
Other	2,481	2,962
Total	3,258	4,074
2-Below-the-line		
War damage	94	77
Loans to local authorities	313	365
Other	136	169
Total	543	611
Net Balance		
1-Above-the-line	+720	+ 366
2-Below-the-line	-470	- 524
3-Overall	+250	- 158

Resistance to the claims for wage increases weakened and wages were allowed to rise more rapidly than at any other time in the post-war period. Between March 1951 and March 1952 wage rates rose by 11 percent. The rise in export prices was equally sharp; between March 1951 and March 1952 export prices rose by 14 percent. During that same period American export prices remained virtually unchanged.

1/ More recent data, which, however, are not as detailed as the above give a still more unfavorable picture of budgetary developments in 1951-52 (The Economist, January 3, 1953, p. 36):

	Million £
Ordinary Receipts	4,433
Ordinary Expenditures	4,054
Net Balance	+ 379
Net Balance on extraordinary expenditures	-551
Overall Balance	-172

On the other hand, industrial production increased by only 2.6 percent in 1951 and there was an actual decline in the first half of 1952. Similarly, there was no increase in agricultural production. Consumption and investment, however, were maintained at their 1950 levels with the result that the large new claims made by the rearmament effort, the deterioration in the terms of trade and the building up of the stocks of raw materials which had been depleted in 1950 could not be met by the British economy.

Finally, due to the failure to interpret correctly the British situation, the deterioration, when it set in, came as a shock both to the British public and to the rest of the world and produced a wave of pessimism about British prospects which added to British difficulties and weakened the standing of sterling beyond what the real situation justified.

B. THE PERIOD OF DETERIORATION JULY-DECEMBER 1951

The effects of these unfavorable developments on the British balance of payments are illustrated in the following table which summarizes the position of Britain's external accounts in the second half of 1951. As a basis for comparison we are using the second half of 1950 rather than the first half of 1951 in order to eliminate the influence of seasonal factors:

(Million £)

Overall Current Account

	2nd Half 1950	2nd Half 1951
Receipts		
Exports	1,183	1,405
Other	492	484
Total	1,675	1,889
Payments		
Imports	1,217	1,848
Other	279	435
Total	1,496	2,283
Net Balance	+ 179	- 394

Overall Capital Account

Investment (-) or borrowing (+)	+ 23	- 99
Sterling balances: net increase (+) or decrease (-)	+ 84	- 68
Net export (-) or import (+) of capital	+ 107	- 167
Grants and defense aid	+ 28	+ 14
Change in gold and dollar reserves	+ 314	- 547

The preceding table indicates that the main factors in the deterioration have been the following;

(a) The value of imports increased by £631 million or 50 percent between the two periods. Of this increase £260 million may be estimated to have been due to a higher volume of imports (the volume of imports increased by 23 percent between the two periods) and £371 million to the higher cost of imports.

(b) Other payments increased by £156 million. An analysis of these payments shows that half the increase was due to increased payments for shipping, reflecting the larger volume of imports, and increased shipping costs and most of the remaining increase was due to larger payments for

interest, profits and dividends.[1/] The doubling of this last item within a year was due largely to the fact that payments of interest on the American and Canadian loans (£39 million) began to be due in the second half of 1951.

(c) The £215 million increase in the value of exports was the result of higher export prices since there was no increase in the volume of exports. If we subtract this figure from the increased cost of imports (£371 million) we find that the deterioration in the terms of trade between the two periods cost Britain £156 million. In view of the fact that in the second half of 1950 Britain had a current account surplus of £179 million, it is clear that the deterioration in the terms of trade which occurred between the two periods could have been taken care of through the elimination of the surplus. There is, therefore, little justification for the widely-held view that the deterioration in the terms of trade was the main cause of the reappearance of a large deficit in Britain's external accounts during the second half of 1951.

(d) While invisible payments, as already stated, increased by 50 percent between the two periods, invisible receipts actually declined. A breakdown of these receipts shows that the cause of the decline was a sharp drop in miscellaneous receipts grouped under the heading "Other (net)":

1/ As follows:

	Million £		
	2nd Half 1950	2nd Half 1951	Increase
Payments			
Shipping	103	180	+ 77
Interest, profits, dividends	56	114	+ 58
Travel	49	63	+ 14
Government transactions	70	77	+ 7
Total	278	434	+156

	Million £	
	2nd Half 1950	2nd Half 1951
Receipts		
Shipping	165	220
Interest, profits, dividends	133	132
Travel	30	38
Other (net)	164	94
Total	492	484

The miscellaneous group covers a wide variety of transactions such as insurance, civil aviation, banking, commissions, earnings of oil companies and so on, but it is also believed to include a balancing item for errors and omissions which are in part accounted for by unrecorded capital movements.[1/]

The fact that the receipts grouped under this heading of "other (net)" tend to be large during periods of confidence and to shrink during periods of distrust suggests that speculative capital movements are an important element of this category of receipts.[2/] The drastic revisions which

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1/ The Economist (October 28, 1950, p. 662) has described this category of receipts as having "some of the appearance of a statistical ragbag into which any untidy trimmings left over after tailoring the statistics of the current account can be gathered".

2/

Receipts Other (net)	Million £
1946	109
1947	98
1948	193
1949	204
1950 - 1st Half	147
1950 - 2nd Half	164
1951 - 1st Half	179
1951 - 2nd Half	80

are constantly being made in the figures[1/] are another indication that changes in this item are an effect rather than a cause of improvement or deterioration in Britain's external position.

(e) In the second half of 1950 there was a net inflow of capital, consisting of borrowing, increase in sterling liabilities and grants, which was nearly as large as the current account surplus. It was the combination of these two factors, the surplus on current account and the net inflow of funds, which resulted in an overall surplus of £314 million in the second half of 1950. During the second half of 1951 the deterioration in Britain's current account position was accompanied by a sharp deterioration in her capital position. The deterioration in the capital account was due to the fact that in the second half of 1951 instead of net borrowing there was net lending and instead of a net accumulation there was a net reduction in sterling balances. These developments were in part inevitable (sterling area countries were bound to draw on the balances they had accumulated in the earlier period) and in part reflected the shift of sentiment concerning the stability of sterling.

1/ The following table shows the range of estimates published in the series of official balance of payments publications for the years 1946 to 1951:

	Million £								
	Receipts under other (net) shown in balance of payments statements of:								
	Sept. 1948	Mar. 1949	Oct. 1949	Apr. 1950	Oct. 1950	Apr. 1951	Oct. 1951	Apr. 1952	Oct. 1952
1946	72	83	83	92	106	109	-	-	-
1947	3	20	20	32	88	98	-	-	-
1948	-	142	130	107	143	188	188	193	-
1949	-	-	-	152	159	209	201	204	203
1950	-	-	-	-	-	315	311	312	316
1951	-	-	-	-	-	-	-	259	284

Summarizing the preceding discussion we may conclude that the principal factors in the emergence of a large British external deficit during the second half of 1951 were larger imports, the servicing of the American and Canadian loans, the running down of sterling balances and capital flight.

A breakdown of the overall figures by major currencies or areas shows more clearly the nature of the deterioration which occurred in 1951:

1. Dollar Area

A comparison between the second half of 1950 and the second half of 1951 shows that the current account deficit increased from £51 million to £334 million while a £365 million surplus on capital account was converted into a deficit of £213 million:

	Million £	
	Current Account	
	2nd Half 1950	2nd Half 1951
Receipts		
Exports	183	194
Other	38	1
Total	221	195
Payments		
Imports	226	427
Other	46	102
Total	272	529
Net Balance	- 51	- 334
	Capital Account	
Receipts		
American grants	96	14
Defense aid	-	1
Dollar surplus of rest of sterling area	91	-
Purchases of gold from rest of sterling area	47	37
Receipts of gold and dollars from other areas	2	-
Liquidation of dollar investments	14	6
Increase in sterling liabilities toward dollar area	47	-
Other imports of capital	85	-
Miscellaneous	8	2
Total	390	60
Payments		
Dollar deficit of rest of sterling area	-	62
Dollar payments to non-dollar countries	-	104
Repayment of Government loans	20	37
Decrease in sterling liabilities to dollar area	-	35
Other exports of capital	-	34
Miscellaneous	5	1
Total	25	273
Net Balance	+ 365	- 213
Increase (+) or decrease (-) in reserves	+ 314	- 547

The preceding table shows that the deterioration in the current account was due to three factors: (a) an increased volume of imports and a lower volume of exports (taking into account the price increases which

occurred during the period); (b) increased non-commercial payments due mainly to the servicing of the American and Canadian loans;[1] and (c) a larger net deficit on the miscellaneous item "other(net)" which reflects the loss of Iranian oil[2] as well as capital movements.[3] The still greater deterioration in the capital account resulted mainly from the following developments: (a) the £91 million dollar surplus of the rest of the sterling area was converted into a £62 million deficit; (b) payments of dollars to non-dollar countries, principally Europe, which had ceased in the previous period, totalled £104 million; (c) the £47 million accumulation of sterling by dollar area countries was converted into a £35 million

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1/

	Million £	
	2nd Half 1950	2nd Half 1951
Payments		
Shipping	24	46
Interest, profits, dividends (including interest on American and Canadian loans)	16	63
Travel	2	3
Government	2	-11
Other	2	1
Total	46	102

2/ The Economic Survey for 1952 states that "purchases of dollar oil to replace Persian oil have been costing the sterling area in this initial period over £100 million a year, the greater part of which is reflected in the United Kingdom's invisible account." (p.15)

3/

	Million £	
	2nd Half 1950	2nd Half 1951
Receipts		
Shipping	26	39
Interest, profits, dividends	28	27
Travel	11	13
Other (net)	-27	-78
Total	38	1

reduction in sterling balances by these countries; (d) an £85 million inflow of dollar funds was converted into a £34 million outflow of such funds; (e) American aid declined from £96 million to £15 million.

These developments confirm the conclusion previously reached that the strength of Britain's dollar position in the first post-Korean year was deceptive and was not likely to endure after import restrictions had been relaxed, the rest of the sterling area had drawn on the dollars earned in the earlier period, American aid had been reduced and confidence in sterling had declined. On the other hand, the extreme unbalance of Britain's dollar accounts in the second half of 1951 did not reflect the true British position vis-a-vis the dollar area. Once sterling area dollar imports had again been tightened up and the distrust in sterling had been dissipated, the British dollar deficit could be expected to return to more reasonable proportions. Thus, the alarm caused by developments in the second half of 1951, like the earlier over-confidence, was exaggerated.

2. Sterling Area

The striking fact about the British external accounts in the second half of 1951 is that while Britain's overall position deteriorated so sharply, her position vis-a-vis the sterling area actually improved. This was due mainly to the fact that exports increased considerably more than imports and so did other receipts. Exports to the sterling area were the only category of British exports which increased in volume in the second half of 1951. Exports to all other areas actually declined during that period. The same applies to other receipts.

In the second half of 1950 most of the current account surplus with the sterling area served to finance British exports of capital to the area and the purchase of newly-mined gold while the large payments made to sterling area countries for the dollars and other currencies they surrendered to Britain were not drawn upon by these countries but were allowed to accumulate in London. We pointed out in the preceding discussion that this was a situation which could not be expected to continue but was likely to be reversed. In the second half of 1951 the sterling area not only ceased to contribute any dollars or other currencies to Britain's reserves but actually drew on these reserves to the extent of £231 million. Most of these drawings were paid for out of earlier sterling accumulations which declined by £311 million. The balance of the decrease in sterling liabilities, together with capital exports and the purchase of newly-mined gold were financed by the British current account surplus with the sterling area. These developments are illustrated in the following

table:

	Million £ Current Account 2nd Half 1950	2nd Half 1951
Receipts		
Exports	528	679
Other	231	279
Total	759	958
Payments		
Imports	500	619
Other	124	157
Total	624	776
Net Balance	+ 135	+ 182
	Capital Account	
Receipts		
Sales of dollars to sterling area	-	62
Sales of other currencies to sterling area	-	169
Increase in sterling liabilities	161	-
Total	161	231
Payments		
Purchases of gold from sterling area	47	37
Purchases of dollars from sterling area	91	-
Purchases of other currencies from sterling area	94	-
Export of capital to sterling area	-	63
Decrease in sterling liabilities	-	311
Other		2
Total	296	413
Net Balance	- 135	-182

The preceding table shows clearly that the pattern of easy selling conditions in the sterling area and of large unrequited British exports to that area, which has been a severe drain on British resources and a serious obstacle to the restoration of equilibrium in Britain's external accounts throughout the post-war period, was also an important factor in the weakening of sterling during the second half of 1951.

3. O.E.E.C. Countries

As in the case of transactions with the dollar area, transactions with O.E.E.C. countries during the second half of 1951 are characterized by greatly increased imports, stationary exports and a serious deterioration in the balance on invisibles. The latter was due mainly to larger payments for shipping and travel and smaller miscellaneous receipts in which, as already stated, are reflected the effects of unrecorded capital movements.[1/] These developments converted a £69 million current account surplus during the second half of 1950 into a £163 million deficit in the second half of 1951. Similar developments in the rest of the sterling area produced a £177 million deficit, which had also to be financed by Britain, in place of the £65 million surplus which had contributed to the strength of Britain's position vis-a-vis the O.E.E.C. countries in the earlier period. The net result of these unfavorable developments was to force Britain to make gold payments of £72 million to the European Payments Union and, in addition, accumulate a huge debt with the Union. The following table illustrates these developments:

1/

	Million £			
	Receipts		Payments	
	2nd Half 1950	2nd Half 1951	2nd Half 1950	2nd Half 1951
Shipping	37	46	30	77
Interest, profits, dividends	7	5	11	14
Travel	7	9	25	33
Government	-	-	6	12
Other (net)	83	67	-	-
Total	134	127	72	136

	Million £	
	Current Account	
	2nd Half 1950	2nd Half 1951
Receipts		
Exports	308	338
Other	134	128
Total	496	466
Payments		
Imports	300	490
Other	73	138
Total	373	628
Net Balance	+69	-162
	Capital Account	
Receipts		
Transfers of gold and dollars to OEEC countries	5	71
Transfers of OEEC currencies from other areas	65	-
Repayment of Government loans	17	17
Increase in sterling liabilities to OEEC countries	4	-
Decrease in official holdings of OEEC currencies	-	15
Decrease in credits or increase in debits with EPU	-	280
Other	1	-
Total	92	383
Payments		
Capital exports to OEEC countries	6	35
Decrease in sterling liabilities to OEEC	-	13
Increase in credits or decrease in debits to OEEC	80	-
Increase in official holdings of OEEC currencies	10	-
Credits under Intra-European Payments Agreement	65	-
Transfer of OEEC currencies to other areas	-	173
Total	161	221
Net Balance	- 69	+162

4. Western Hemisphere Other Than Dollar Area

Again the same pattern of deterioration which characterized British transactions with all other non-sterling regions in the second half of 1951 is visible in transactions with Latin American countries, namely, stationary or declining volume of exports, accompanied by greatly increased imports and resulting in a shift from a surplus to a deficit position:

	Million £	
	Current Account	
	2nd Half 1950	2nd Half 1951
Receipts		
Exports	56	57
Other	38	39
Total	94	96
Payments		
Imports	57	109
Other	3	3
Total	60	112
Net Balance	+ 34	- 16
	Capital Account	
Receipts		
Increase in sterling liabilities	-	2
Sales of investments	26	13
Other capital transactions	-	20
Total	26	35
Payments		
Decrease in sterling liabilities	43	-
Exports of capital	6	-
Other	11	19
Total	60	19
Net Balance	- 34	+ 16

The degree of deterioration which occurred in the British external position during the second half of 1951 was as sharp and unexpected as that of two years earlier which led to the devaluation of the pound. There were, however, two differences between the two periods which made the new deterioration appear even more serious than the earlier one: (a) since 1949 industrial production had increased by nearly 10 percent and exports by some 15 percent. The fact that these gains had not been able to prevent the reappearance of a large external deficit seemed to suggest that the British external difficulties were virtually insoluble; (b) sterling had already been devalued drastically, which meant that relief could no longer be sought through a new readjustment of the rate of exchange. Indeed, what made the British external weakness so disquieting was that it occurred at a time when sterling still appeared undervalued in terms of purchasing power comparisons. It was clear that the situation called for drastic measures to arrest the deterioration as well as for a reassessment of Britain's economic position.

C. THE RECOVERY IN 1952

I. - The New Government Measures

The new Conservative Government to which fell the task of meeting the crisis proceeded along the following lines.

The first measure, which was adopted in November 1951, was the familiar one of import cuts. The new restrictions were intended to reduce payments for imports by £290 million and to save another £60 million by cutting down spending on foreign travel, shipping and overseas government expenditures. Part of the reduction was expected to result from lower prices. These economies involved the following cuts in the main categories of foreign exchange expenditures:[1]

	£ million
Private food imports	100
Government food imports	60
Raw materials and manufactures	30
Stockpiling	100
Tourist allowances	15
Shipping, Government overseas spending etc.	45
Total	350

It was estimated that about half the reduction in imports would result from the reinstatement of quotas on European goods which had been abolished under the OEEC liberalization program.[2] Thus European exports were expected to bear the brunt of the British import cuts.

1/ See Economist, November 10, 1951, P.1129

2/ Before the cuts trade liberalization covered 90% of private British imports from Europe. After the cuts the proportion of liberalized imports was expected to be only 60%.

Simultaneously with the decision to prune foreign exchange expenditures, a series of steps were taken which were intended to check credit expansion and produce a tighter monetary situation in the country: (a) The Bank rate was raised from 2 to 2½%; (b) the ½% market rate for Treasury bills was unpegged; and (c) a funding operation converted £1,000 million of 60-day Treasury bills into one- and two-year bonds at 1 3/4%; and (d) new directives were issued to the Banks to scrutinize more rigorously all demands for advances and limit bank financing to essential purposes.

The rise in bank rate was not large enough to have any appreciable effect on the cost of borrowing[1/]: it was primarily intended as a warning that "a new era had begun in which credit would become steadily scarcer and more expensive". Similarly the unpegging of the market rate for Treasury bills was not expected to result in large increases in market rates or in a withdrawal of government support from the market. The intention of the authorities was merely to operate at varying rates instead of the fixed rates of the postwar period and thus to create some uncertainty in the market. In the words of the Economist[2/] they meant to go "just as far as was practicable to demolish the pernicious automaticity of costless cash supply - a system that, for a decade and more, has been depriving them of all real control over the volume of money".

1/ In fact the rate remained unchanged at 2% for seven-day loans against Treasury bills and since this is the prevalent form of loans from the Bank of England the 2% rate was expected to be the rate most used.

2/ November 10, 1951, P.1125.

The purpose of the funding operation was to reduce the liquidity of the Banks and hence their ability to make loans and advances. The effect of the funding was to bring down the liquidity ratio of the banks from 39% to 33.2%. Since the conventional liquidity minimum is 30%, the effect of the operation was not to force the banks to contract their lending but merely to bring them nearer the point where they would be unable to expand their lending activities in case they wished to do so.

For the tightening up of credit which they wished to bring about, the authorities continued to rely on exhortations to the banks to show restraint and observe the established criteria of national interest in making loans. In response to the new Government's plea for restraint the banks issued a statement promising full cooperation:

"We must warn every trader and every individual borrower that requests for advances will be more and more critically examined and that Bank borrowing will tend to become more expensive." 1/

The acclaim with which the monetary measures of the new Government were greeted by the advocates of orthodox finance was based, not so much on what these measures themselves were capable of accomplishing, but on the expectation that they were only the first instalment in a new policy which would rely increasingly on the use of monetary weapons for the restoration of equilibrium in the economy.

Following the Conference of Commonwealth Finance Ministers in January 1952 the British Government announced a supplemental program for

1/ Quoted from Economist, December 1, 1951, P.1351.

dealing with the external and internal crisis. The program provided for new import cuts, restrictions on industrial investment and home consumption and some tightening up in public spending.

The additional restrictions on imports and other foreign exchange expenditures were expected to save some £150 million over and above the £350 million decided upon in November 1951. The cuts in industrial investment were expected to release some £150 to £200 millions worth of machinery and equipment for export.[1] This diversion of capital goods to foreign markets was to be achieved through a combination of measures, namely discriminatory steel allocations, voluntary agreements with engineering firms, the withdrawal of the system of initial tax allowances and the tighter monetary policy in force. Cuts in the home supply of durable consumption goods were expected to release some £70 million of such goods for export. Again the cuts were to be effected through discriminatory steel allocations and through the tightening up of the rather liberal terms under which consumer credit had been available to the public until then. Finally, pending the introduction of the new Budget, the Government announced several minor economies in public spending and the raising of health charges by £20 million. On the other hand, it was stated that the housing program would not only be left intact but would actually be expanded to reach a rate of 300,000 new houses per annum at the end of three years compared with the current rate of 200,000.[2]

1/ The severity of the projected cuts may be gauged from the fact that total industrial investment in 1950 was estimated to have amounted to £500 million (Economist, February 2, 1952, P.294).

2/ See Economist Feb.2, 1952, P.265, which quotes the Minister of Housing as having stated that housing should be treated as "a military operation" and plans should be laid for an expanding program which would produce 300,000 houses a year - "at the end of say, three years". "Money is not the difficulty; the Government has decided that all the money needed shall be forthcoming."

The last instalment of the new Government's economic program came with the Budget in March 1952 and consisted of the following measures:

The Budget itself contained several important innovations but on balance it left the impact of public finances on the economy unchanged. The most important measures strengthening the Government's finances were the cut in food subsidies by 40%, from £410 million to £250 million, the imposition of an excess profits levy expected to yield £100 million in a full year and increases of £63 million in petrol taxes and £14 million in postal charges. These measures, however, were offset by tax reliefs for lower incomes and for extra earnings estimated at £229 million in a full year and by increases in pensions estimated at £80 million. It is true that tax yields in 1952-53 were expected to increase by some 10% compared with the previous year due to higher prices and incomes but this increase was likely to be offset by the rise in expenditures resulting from the same cause and from higher defense spending so that on balance no net improvement in the fiscal position appeared in sight for 1952-53. The estimates for expenditures submitted in March 1952 envisaged an increase of £181 million in ordinary expenditures compared with 1951-52 and no increase in net extra-ordinary expenditures. This implied an improvement of over £90 million in the overall fiscal position:

	£ Million	
	1951-52 Actual	1952-53 Budget Estimates 1/
Ordinary Revenue	4,433	4,661
Ordinary Expenditure	4,054	4,235 1/
Net Balance	+379	+426
Extraordinary Revenue	87	106
Extraordinary Expenditure	638	612
Net Balance	-551	-506
Overall Balance	-172	-80

These estimates, however, were stated to be highly tentative and subsequent developments suggest that the actual position has been far less favorable. Data for the first nine months of the current fiscal year show that instead of an improvement there has been a substantial deterioration which can only partly be offset by a better performance in the last three months:

	£ Million	
	Nine months April-December	
	1951-52	1952-53
Ordinary Revenue	2,682	2,612
Ordinary Expenditure	2,908	3,201 2/
Net Balance	-226	-589
Net Balance of Extraordinary Expenditure	-376	-426
Overall Balance	-602	-1,015

Taking into account that the overall deficit for 1951-52 was £172 million, a dificit of £602 million in the first nine months of the fiscal year implies a surplus of £430 million in the last quarter of that year. Even if we assume

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1/ Based on Financial Statement but adjusted by the Economist to include the £85 million of defense aid in net expenditure in order to show true domestic expenditure comparable with previous years. See Economist, January 3, 1953, p. 36.

2/ Includes £64 million of expenditure offset by defense aid as described in previous footnote.

that the surplus will increase to £600 or even £700 million in the last quarter of fiscal 1952-53 due to the fact that the higher tax revenue and the savings on food subsidies will have been concentrated in the second half of the fiscal year, the overall deficit will be at least £300 million compared with the original budget estimates of only £80 million.

Simultaneously with the introduction of the Budget, the Chancellor of the Exchequer announced an increase in Bank rate from 2½ to 4%. This was described as a dramatic move intended to impress public opinion with Britain's determination to tackle its economic difficulties. The contrast between the softness of the Government's budgetary policy and the toughness of its monetary policy was interpreted as indicating that henceforth the authorities intended to rely primarily on monetary measures for the restoration of equilibrium in the British economy.

The Government rounded off its program by decreeing additional cuts in imports amounting to some £100 million. Most of these cuts were made in imports from Western Europe and meant that only 46% of private British imports from Europe would be free from quantitative import restrictions compared with 90% in October 1951.

The Government expressed confidence that the measures adopted would prove adequate to meet the situation and restore internal and external balance. This confidence was based on the following calculations:

In 1951 Britain experienced an external deficit of £516 million. The £600 million cut in the import program decreed by the Government was expected to result in a reduction of some £300 million in actual foreign exchange expenditures in fiscal year 1952-53 compared with 1951-52. An additional

gain of £200 to £250 million was expected from improving terms of trade and higher invisible earnings. Adding an increase in exports of £50 million anticipated by the Government the total improvement in the balance of payments seemed amply sufficient to close the external gap.

With regard to the internal strain on the economy that would result from this decrease in imports and increase in exports as well as from the increase in defense expenditures, the Government expected the situation to be met as follows:

Cuts in supplies and additional claims on available resources	£ Million
Reduction in imports	300
Increase in exports	50
Increased defense spending	200
Total	550

To be offset by:

Reduction in stocks	150
Increase in production	250
Reduction in domestic investment	100
Cut in non-defense Government spending	50
Total	550

Thus, the Government concluded, there was no need to cut down consumption and hence there was no need for a stricter budget. Similarly, the earlier intention to divert £270 million worth of metal goods to foreign markets seemed to have been abandoned.

Comparing developments in 1952 with Government expectations we find that the hoped-for improvement was largely realized. By the middle of 1952 balance had been restored in the overall external position and prices were

much more stable than a year earlier. The means, however, by which the improvement was brought about were very different from those envisaged by the Government: the only factor which played the part expected from it by the Government were import cuts.

Comparing the six-month period April-September 1952[1] with the corresponding period of 1951 we find that industrial production declined by 7% instead of increasing by £250 million per annum or by some 3%, as anticipated by the Government. During the same period the volume of exports fell by 13%, again instead of increasing. Similarly, in spite of the tighter monetary policy there was no decrease in the volume of credit. It is true that Bank advances to private borrowers fell but this reduction was offset by increased Government borrowing due to the larger budget deficit which, moreover, since the restoration of external balance, was no longer offset by sales of foreign exchange.[2] As a result, Bank liquidity which, as already stated, had been brought down by the funding operation of November 1951, rose steadily during 1952 and by September the ratio was again 38%.[3] No information

1/ The last month for which data on industrial production are available.

2/ The changes in bank lending during that period have been as follows:

	April-September 1951	April-September 1952
	(Million £)	
Bank advances	+ 111	- 205
Bills discounted (mostly Treasury Bills)	- 24	+ 412
Total	+ 87	+ 207

3/

	Ratio of liquid assets to total deposits
April 18, 1951	38.8 percent
October 17, 1951	39 "
January 16, 1952	32.1 "
April 16, 1952	31.6 "
July 16, 1952	35.8 "
September 17, 1952	37.9 "

is yet available on domestic investment but there are indications that any decline which occurred in private investment was more than offset by increased public investment.[1/]

The factors accounting for the improvement of the British position in 1952 appear to have been the following:

Externally, the same factors which had enabled Britain to overcome the earlier postwar crises seem to have been in operation again, namely cuts in imports, reversal of capital flight, better terms of trade.

Internally, the picture is not yet clear as no data for the whole year are yet available on consumption, investment and savings but it seems that the principal factor in the improvement has been the drawing down of the large stocks built up in 1951 by business, Government and consumers. It is also probable that there was an increase in personal saving.

1/ Information on new capital issues in 1952 suggests that there was a very large increase in long-term borrowings in 1952. The increase, however, was due entirely to increased borrowing by the Government and by nationalized industries and it reflects only in part an increase in physical investment:

	New Capital Issues (Million £)	
	1951	1952
Government	109.5	515.4
Government Corporations	3.2	4.8
Companies	123.5	106.9
Empire	55.7	51.0
Foreign	9.7	-
Total	301.6	678.1

II. - The External Improvement and Its Significance

Comparing the first half of 1952 with the second half of 1951 we find that a current account deficit of £394 million was converted into a £24 million surplus.

The main factors in the change were the following:

	Million £
Increase in export receipts	111
Decrease in import payments	248
Improvement in the balance on invisibles	59
Total	418

The improvement in invisibles was not real, it was largely due to the fact that the second half of 1951 included £39 million for interest on the American and Canadian loans. With regard to the trade balance, it is not possible, on the basis of balance of payments data, to determine to what extent the improvement was due to changes in volume and to what extent it was due to changes in prices or other causes. Such a determination can be made only on the basis of trade returns which, however, differ from balance of payments data in several respects and especially in timing.[1] If we assume that there is an average time difference of three months between the two sets of figures[2] and apply the volume and price indices

1/ The balance of payments trade data are derived from Exchange Control sources and record the value of transactions when a change in the ownership of goods takes place. For a large proportion of imports this change occurs in the country of origin. For exports, the transfer of ownership usually takes place on or after arrival in foreign ports. The trade statistics, on the other hand, record actual arrivals and shipments of goods in British ports and they value imports c.i.f.

2/ For imports this means assuming that balance of payments data for a given quarter correspond to trade statistics for the next quarter while for exports it means that balance of payments data for a given quarter correspond to trade statistics for the previous quarter.

available for trade returns to balance of payments data we may obtain an approximate idea of the factors which brought about the improvement in the trade balance during the first half of 1952. Such a calculation suggests that cuts in imports accounted for £ 200 million of the £ 359 million improvement in the trade balance and more favorable terms of trade for another £ 113 million, as follows:

	Million £
Decrease in volume of imports	200
Lower import prices	48
Increase in volume of exports	26
Higher export prices	65
Larger re-exports	20
Total	359

In spite of the balanced position on current account there was a decrease in the gold and dollar reserve of £ 232 million. The overall balance of payments seems to suggest that the decrease in the reserve was due to the drawing down of sterling balances but this, as pointed out earlier, is misleading. The actual position is that Britain had a current account surplus with sterling countries which financed the repayment of sterling debts and a current account deficit with dollar countries which, to the extent that it was not offset by American aid, caused a decline in the reserve. This is why in order to understand the developments in Britain's position during that period, it is necessary to breakdown the overall balance of payments into currency or regional groupings:

The Overall Balance of Payments
Million £

	1951 1st Half	Second Half	1952 1st Half
	Current Account		
Receipts			
Exports	1310	1405	1516
Other 1/	598	505	523
Total	1908	1910	2039
Payments			
Imports	1646	1848	1600
Other 1/	333	456	415
Total	1979	2304	2015
Net Balance	-71	-394	+24
	Capital Account		
Investment (-) or Borrowing (+)	-163	-99	+31
Change in Sterling balances: increase (+) or decrease (-)	+404	-68	-345
Net balance on capital account	+241	-167	-314
Grants and defense aid	+33	+14	+58
Change in reserves	+203	-547	-232

1/ Until recently Government transactions were given on a net basis and were shown on the debit side of the current account. In the latest balance-of-payments data they have been broken down into credit and debit items and shown separately. In this and the following tables we are using the new figures and this is why the amounts shown under other receipts and payments for 1951 differ from those of the earlier tables. The net balance of this item is of course the same.

1. The Dollar Area

The following table shows the developments in the British accounts with the dollar area in the first half of 1952:

	1951 1st Half	Second Half	1952 1st Half
		Current Account	
Receipts			
Exports	188	194	193
Other	65	17	33
Total	253	211	226
Payments			
Imports	304	427	356
Other	62	118	75
Total	366	545	431
Net Balance	-113	-334	-205
		Capital Account	
Receipts			
American grants	47	15	58
Defense aid loan	-	-	17
Dollar surplus of rest of sterling area	155	-	-
Purchase of gold from rest of sterling area	41	37	52
Receipts of gold and dollars from other areas	48	-	-
Liquidation of dollar investments	11	6	12
Imports of capital	31	-	18
Miscellaneous	6	2	-
Total	339	60	157
Payments			
Dollar deficit of rest of sterling area	-	62	41
Dollar payment to non-dollar countries	-	104	120
Repayment of loans	14	37	3
Decrease in sterling liabilities in dollar area	-	35	20
Exports of capital	9	34	-
Miscellaneous	-	1	-
Total	23	273	184
Net balance on capital account	+316	-213	-27
Change in reserves	+203	-547	-232

The main conclusions from the preceding table are as follows:

(a) Between the second half of 1951 and the first half of 1952 Britain's current account deficit with the dollar area decreased from £ 334 million to £ 205 million. If we deduct the £ 39 million for interest on the American and Canadian loans, which were a seasonal factor, we find that the real improvement in the dollar current account amounted to £ 90 million of which £ 71 million were due to a decrease in imports and most of remaining improvement to smaller payments under the heading of "other (net)", which as pointed out earlier, refects mainly unrecorded capital movements.

(b) In the second half of 1951 Britain had a deficit on capital account almost as large as its current dollar deficit, due primarily to large dollar payments to non-dollar countries (principally EPU), to the financing of the sterling area's dollar deficit, to amortization on the American and Canadian loans and to capital exports. In the first half of 1952 the movement of capital was reversed: instead of an outflow of £ 34 million there was an inflow of £ 18 million. This, together with an increase in American aid from £ 15 million to £ 75 million, and some other favorable changes reduced the capital account deficit from £ 213 million to £ 27 million. as follows:

	Million £
Increase in American aid	60
Change in capital movements	52
Seasonal character of amortization on American and Canadian loans	23
Other favorable changes	51
Total	£ 186

These developments in the first half of 1952 indicated that a further improvement in Britain's dollar position was in sight for the second half of the year. The decision to tighten up dollar imports taken at the Commonwealth Conference was bound to result in still lower British imports in the second half of the year as well as to reduce the dollar deficit of the rest of the sterling area. The restrictions imposed on British imports from EPU countries were likely not merely to eliminate the £ 120 million deficit with non-dollar countries but actually to convert it into a surplus. The reversal of capital flight could be expected to continue under the influence of the increased confidence resulting from Britain's improved position. Thus a dollar surplus for the second half of 1952 could be confidently anticipated.

2. The Sterling Area

The British accounts with the rest of the sterling area during the first half of 1952 have been as follows:

Million £

	1951 1st Half	Second Half	1952 1st Half
		Current Account	
Receipts			
Exports	581	679	755
Other	300	279	292
Total	881	958	1047
Payments			
Imports	654	619	603
Other	139	157	176
Total	793	776	779
Net Balance	+88	+182	+268
		Capital Account	
Receipts			
Sales of dollars to sterling area	-	62	41
Sales of other currencies to sterling area	-	169	12
Increase in sterling liabilities to sterling area	368	-	-
Total	368	231	53
Payments			
Purchases of gold from sterling area	41	37	52
Purchases of dollars from sterling area	155	-	-
Purchases of other currencies from sterling area	170	-	-
Exports of capital	70	63	34
Decrease in sterling liabilities	-	311	234
Other	-	2	2
Total	436	413	322
Net Balance	-68	-182	-268

The preceding table shows that the already large current account surplus with the sterling area increased still further in the first half of 1952 due to the increase in British exports to the area. The surplus was financed almost entirely through sterling balances and capital exports. Thus the pattern of large unrequited British exports to the sterling area continued during that period. The fact, however, that sterling balances had been reduced by £ 543 million within a year and that inflation was being brought under control in the sterling area suggested that a smaller British current account surplus with that area was in sight for the second half of 1952.

3. The OEEC Countries

The British accounts with the OEEC countries during the first half of 1952 were as follows:

Million £

	1951 1st Half	Second Half	1952 1st Half
		Current Account	
Receipts			
Exports	365	338	366
Other	134	128	109
Total	499	466	475
Payments			
Imports	435	490	419
Other	90	138	124
Total	525	628	543
Net Balance	-26	-162	-68
		Capital Account	
Receipts			
Transfers of gold and dollars to OEEC countries	-	71	125
Transfers of OEEC currencies from other areas	95	-	-
Repayment of Government loans	6	17	5
Increase in sterling liabilities to OEEC countries	27	-	-
Decrease in holdings of OEEC currencies	23	15	4
Decrease in credits or increase in debits with EPU	-	280	61
Imports of capital	-	-	20
Other	1	-	-
Total	152	383	215
		Capital Account	
Payments			
Acquisition of gold and dollars from OEEC countries	37	-	-
Transfers of OEEC currencies to other areas	-	173	87
Decrease in sterling liabilities	-	13	60
Increase in credits or decrease in debits with EPU	34	-	-
Government lending	22	-	-
Exports of capital	33	35	-
Total	126	221	147
Net balance on capital account	+26	+162	+68

Again we see that import cuts were the main factor in the improvement of the current account while on capital account smaller payments to OEEC countries resulted from the smaller deficit of the sterling area and other overseas areas with OEEC as well as from a reversal of capital movements.

The preceding table shows that during the first half of 1952 Britain had to meet a total deficit of £ 215 million with OEEC countries consisting of three major items and met from three major sources, as follows:

Deficit with OEEC countries	Million £	Means of financing	Million £
British current account deficit	68	Transfers of gold	125
Deficit of other areas	87	EPU credit	61
Decrease in sterling balances	60	Imports of capital	20
		Other	9
Total	215	Total	215

As already stated, this deficit was likely to be converted into a surplus in the second half of 1952 as a result of the cuts in imports decreed by both Britain and the rest of the sterling areas, of smaller decreases in sterling balances and a larger inflow of funds.

4. The Western Hemisphere Other Than the Dollar Area

Britain's accounts with Latin American countries during the first half of 1952 show that exports were maintained but imports declined sharply, due in part to the fall in prices and in part to a decrease in volume. The result was a large current account surplus, the bulk of which was financed out of sterling balances, i.e. in the same way as Britain's current surplus with the sterling area:

Million £

	1951 1st Half	1951 Second Half	1952 1st Half
	Current Account		
Receipts			
Exports	57	57	61
Other	43	39	42
Total	100	96	103
Payments			
Imports	74	109	45
Other	4	3	4
Total	78	112	49
Net Balance	+22	-16	+54
	Capital Account		
Receipts			
Liquidation of investments	4	13	3
Increase in sterling liabilities	10	2	-
Other capital imports	-	20	-
Total	14	35	3
Payments			
Transfers of gold and dollars	-	-	8
Transfers of other currencies	4	19	-
Sterling drawings on IMF	10	-	-
Revaluation payments	11	-	-
Decrease in sterling liabilities	-	-	49
Other capital exports	11	-	-
Total	36	19	57
Net Balance	-22	+16	-54

It is clear from the preceding table that the large British surplus with Latin America in the first half of 1952 was only a temporary phenomenon which would disappear as soon as British imports from the area were resumed. Nor was it a healthy development considering how much Britain needed the primary products available in Latin America.

Summing up the preceding discussion we conclude that the improvement in Britain's dollar position in the first half of 1952 was due primarily to cuts in imports from the dollar area and from OEEC countries, to the reversal of capital flight and to larger American aid. The fact that Britain's external accounts were in overall balance in the first half of 1952 was of no special significance since the balance concealed a large surplus with the sterling area financed through the depletion of sterling balances and a substantial deficit with the dollar area financed through American aid and a decline in the gold reserve. We also find that during that period a marked shift took place in the structure of British trade. As a result of the fact that the bulk of the increase in exports went to the sterling area while the bulk of the decrease in imports occurred in imports from non-sterling area countries 1/ the already large share of the sterling area in British trade increased still further:

Percent of Total

	Exports		Imports	
	2nd Half 1951	1st Half 1952	2nd Half 1951	1st Half 1952
Sterling area	48.5	50.2	33.5	37.5
Dollar area	13.8	12.7	23.2	22.2
Other Western Hemisphere	4.0	4.0	5.8	2.8
OEEC countries	24.1	24.1	26.4	26.2
Other	9.6	9.0	11.0	11.0

1/

	Changes in imports between 2nd half 1951 and 1st half 1952	Changes in exports between 2nd half 1951 and 1st half 1952
	Million £	
Sterling area	- 16	+ 76
Dollar area	- 71	- 1
OEEC countries	- 71	+ 28
Western Hemisphere	- 64	+ 4
Other	- 26	+ 4
Total	- 248	+ 111

Balance of payments data are not yet available for the second half of 1952 but the fact that the gold and dollar reserve increased by £ 57.5 million during that period in spite of the servicing of the American and Canadian loans indicates that the £ 232 million dollar deficit of the first half of 1952 was converted into a surplus. The sources of the improvement have been tentatively estimated as follows: 1/

Million Dollars

	1st half 1952	2nd half 1952
EPU Settlements	- 362	+ 86
Dollar cost of "arbitrage" commodities sold to EPU	-	- 170
Other gold and dollar settlements	- 490	+ 200
Servicing of American and Canadian loans	-	- 181
American defense aid	+ 202	+ 226
Change in reserve	- 650	+ 161

The preceding table shows that the anticipated improvement in Britain's position with EPU did materialize in the second half of 1952. Similarly, there was a very sharp improvement in the position vis-a-vis the dollar area indicated by the fact that a $490 million deficit was converted into a $200 million surplus. No information is yet available on the factors which contributed to this dramatic improvement but it is possible to infer the nature of the improvement from an analysis of the dollar deficit during the first half of 1952:

1/ Economist, January 10, 1953, p. 96.

Net Gold and Dollar Balance
Million $

	1st half 1952
1. United Kingdom	
Current account with dollar area	- 574
Capital account with dollar area	+ 20
Net	- 554
2. Rest of Sterling Area	
Dependent territories	+ 190
Independent countries	- 304
Gold sales to U.K.	+ 145
Net	+ 31
3. Dollar transactions of U.K. and rest of Sterling area with non-dollar countries other than EPU	+ 15
Total net deficit	- 508 1/

The developments which are most likely to have converted this $500 million deficit into a $200 million surplus may be assessed as follows:

(a) There was probably a further decrease in U.K. imports from the dollar area. Trade statistics show that imports from the dollar area in the third quarter of 1952 were lower than in the first and second quarters 2/ and while trade returns, as already stated, lag behind actual payments for imports

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1/ The above data are obtained from the official Balance of Payments Statement. The difference between the net total of $508 million and The Economist figure of $490 million is due to slight differences in estimates:

	Economist	Balance of Payments
	Million $	
EPU	- 362	- 351
American aid	+ 202	+ 210
Dollar deficit	- 490	- 508
Change in gold reserve	- 650	- 649

2/ Trade Statistics - Imports from Dollar Area

1952	Million £
1st quarter	210.0
2nd quarter	211.5
3rd quarter	159.4

it is probable that the trend towards lower imports continued in the fourth quarter of 1952 and the first quarter of 1953 and was therefore reflected in the balance of payments of the second half of 1952. It seems reasonable to assume that payments for dollar imports in the second half of 1952 were lower than in the first by about $200 million.

(b) There may also have been an increase in export receipts. Trade statistics show that British exports to the dollar area have been as follows during 1952:

	Million £
4th quarter 1951	72.6
1st " 1952	73.7
2nd " "	80.1
3rd " "	81.9

Receipts from exports may have increased by some $50 million in the second half of 1952.

(c) Experience shows that speculation on sterling can produce violent swings in Britain's dollar position. Since 1949 dollar transactions on capital account have shown the following fluctuations:

	Million $
1948	-237
1949	+ 16
1950	+397
1st half 1951	+ 39
2nd half 1951	-281
1st half 1952	+ 20

It is very probable that the restoration of confidence in the British position again produced a sharp inflow of funds which, on the basis of past experience, may have been as high as $200 million. 1/

1/ According to the Economist (March 29, 1952, P.808) "past experience suggests that the swing of the semi-speculative, semi-commercial psychological pendulum from one extreme when sterling is being "beared" to another when sterling is being "bulled" may amount to as much as £500 million - not an implausible figure when it is realized that international trade financed in sterling amounts to over £10,000 million."

(d) It is probable that the dollar surplus of the dependent territories and gold sales to the U. K. were maintained and that the dollar deficit of the independent sterling area countries was largely eliminated following the imposition of drastic import restrictions which was decided upon at the Commonwealth Conference. If this has been the case the result will have been an improvement of the order of $200 to $300 million in the British dollar position.

Summing up the preceding calculations we find that the probable sources of the recent improvement have been as follows:

	Million $
Cut in imports	200
Increase in exports	50
Capital movements	200
Improvement in dollar position of sterling area	250
Total	700

If these calculations correspond even approximately to the real situation they give a rough idea of Britain's dollar accounts in the second half of 1952:

	Million $ 1952	
	1st half	2nd half
1. United Kingdom		
Imports from dollar area	- 998	- 800
Exports to dollar area	+ 541	+ 600
Other current payments (net)	- 117	- 100
Capital transactions	+ 20	+ 200
Net Balance	- 554	- 100
2. Rest of Sterling Area		
Dependent territories	+ 190	+ 200
Independent countries	- 304	- 50
Gold sales to U.K.	+ 145	+ 150
Net Balance	+ 31	+ 300

	1952 1st half	1952 2nd half
3. Dollar transactions with Non-dollar countries:		
EPU	- 351	- 84 1/
Other	+ 15	-
4. Servicing of American Loan	-	- 181
5. American aid	+ 210	+ 226
6. Change in gold reserve	- 649	+ 161

Expressed as annual figures and after elimination of the inflow of funds, which is obviously of a non-recurring character, these estimates suggest that under the conditions which obtained in the second half of 1952 Britain would have been able to cover its own deficit with the dollar area with its purchases of gold from the sterling area and with the surplus of the dependent territories, while the rest of the sterling area was taking care of most of its own dollar needs. In that case the British dollar deficit would have been equal to the payments due for the servicing of the American and Canadian loans:

	Annual Dollar Balance Million $
1. United Kingdom	
Imports	- 1600
Exports	+ 1200 2/
Other	- 200
Net	- 600
2. Rest of Sterling Area	
Dependent territories	+ 400
Independent countries	- 100
Gold sales to U.K.	+ 300
Net	+ 600

1/ Obtained by deducting the $86 million surplus with EPU from the $170 million cost of commodity arbitrage.
2/ This is probably on the higher side.

	Annual Dollar Balance Million $
3. Servicing of American and Canadian loans	- 181
4. Net Overall Balance	- 181

The question that arises in trying to assess Britain's dollar problem is how far the preceding estimate of the British dollar accounts during the second half of 1952 can be considered as typical of the conditions that are likely to obtain in the coming years. It is clear that if there is scope for a further cut in imports, for a further expansion in exports, for larger colonial surpluses and for higher receipts from gold, the British dollar position will improve markedly in the coming years. If, on the other hand, imports during the second half of 1952 were too low for long-term equilibrium, if exports had reached their peak and if the colonial surpluses could not be maintained at their 1952 levels, a deterioration in Britain's dollar position would seem to be in sight.

The fear has been expressed that the cuts in dollar imports decided upon in 1952 were once again made at the expense of stocks and hence will give only temporary relief to the British dollar position. This was denied a few months ago by the Government which stated that raw material stocks at the end of September were on the whole higher than a year earlier. Against this, however, it has been pointed out, first, that the full impact of the new import restrictions had not yet been felt by September and second, that consumption of raw materials in 1952 had been below normal due to the decline in industrial production. Thus, during the first nine months of 1952 consumption of cotton fell by 30% compared with the second half of 1951, con-

sumption of sulphur by 12%, of woodpulp by 8% and of lead by 36%.

Whether stocks will prove adequate or not, it is unlikely that dollar imports will be maintained at their recent levels if there is any relaxation in the very severe restrictions against dollar goods decided on in 1952. The same applies to the dollar imports of the independent countries of the rest of the sterling area and hence to the prospects of a balancing of their dollar accounts in the coming years.

With regard to exports, continued high levels of economic activity in the United States and a lowering of trade barriers should enable Britain to expand her sales in the American market, assuming that British prices continue to be competitive. If, however, American economic activity declines in the coming years and if there is no lowering of trade barriers, British exports to the United States are likely to fall. American economic conditions will determine the prospects of British sales not only in the United States but also in other dollar markets since a decline in American economic activity is bound to affect the other countries of the dollar area, as well as lead to more aggressive selling by American business in these markets. It is true that there is considerable scope for an increase in British sales to such expanding dollar markets as Canada and dollar countries of Latin America like Venezuela, Mexico, etc. Such an increase, however, would require a very drastic change in present British policies since it is unlikely to take place while Britain allows large exports of capital to the sterling area. On the basis of present indications no substantial expansion in British dollar exports appears likely in the coming years.

The size of future colonial surpluses will depend in part on the level of demand, and hence on American conditions, and in part on develop-

ments in the colonial territories themselves. In the long run the territories are certain to seek greater independence which is likely to include greater control over their dollar earnings. Against this probable loss of dollars to Britain must be set the possibility of a rise in the price of gold which, however, depends entirely on American decisions.

Finally, any increase in dollar earnings that may be achieved by the independent countries of the sterling area will be needed to meet the dollar requirements of the countries themselves so that no improvement in Britain's dollar position is probable on that score. On the other hand, it is unlikely that Britain will continue to meet the deficits that may from time to time tend to develop in the dollar accounts of these countries. Thus, the prospects are that in the coming years the dollar position of the independent sterling area countries will cease to be an important factor in Britain's dollar problem.

In the light of these considerations a substantial improvement in Britain's present dollar position appears unlikely in the coming years while a serious deterioration is certain to take place in the event of a decline in American economic activity. And, it must be remembered, the real present position is that Britain can barely meet her dollar needs even after

cutting imports of dollar goods to the bone. 1/

1/ Since the recent import cuts are not fully reflected in the latest available trade statistics it is not yet possible to determine how the current level of dollar imports compares with prewar. If we assume that the rate of imports during the last four months for which returns are available, i.e. July-October 1952, had not yet fully reflected the cuts in imports decided upon in 1952 and if we further assume that the dollar prices of imports have increased by 120 percent compared with prewar, which is probably an underestimate, we reach the conclusion that the volume of current dollar imports is one-third less than before the war. Taking into account such factors as the higher levels of employment in Britain, the increase in population, the loss of sources of supply in Eastern Europe and elsewhere, we are bound to conclude that current dollar imports are considerably below normal requirements and can be held at this low level only through severe import restrictions. The following table is based on U.K. trade statistics:

United Kingdom Imports (c.i.f.) from Dollar Area
(Million $)

	Total	U.S.A.	Canada	Other
1938	1080	590	410	80
1950	1344	590	504	250
1951	2173	1064	728	381
1952:				
1st half (annual rate)	2372	1112	935	325
July-Oct. (annual rate)	1784	664	910	210

Assuming an increase in prices of 120 percent, prewar imports correspond to some $2340 of current dollars. Assuming that imports in July-October 1952 had not yet fully reflected the effects of recent imports cuts, we may conclude that the current rate of imports is about $1600 million per annum. This is 68 percent of the prewar rate.

Another question raised by developments in Britain's external position in 1952 is whether the decline in the volume of British exports to non-dollar markets which took place during that period portends future difficulties in selling to non-dollar markets as well, and hence future balance of payments difficulties with areas other than the dollar area.

Overall British exports in 1952 declined by only 1 percent in terms of value but since export prices increased by 5 percent this implies a decline in volume of 6 percent.

The whole of the decline occurred in exports of textiles, which decreased sharply, and in exports of other consumer goods, vehicles and chemicals. Exports of coal, iron and steel and machinery, on the other hand, increased substantially

	Million £	
	1951	1952
Increases		
Coal and coke	34	65
Iron and steel	159	192
Electrical goods and machinery	460	532
Decreases		
Textiles	538	381
Other consumer goods 1/	297	280
Vehicles	480	479
Chemicals	143	138

1/ Including miscellaneous manufactures.

Similarly, the whole of the decline in exports during 1952 occurred in the last three quarters of the year. The rate of exports in the first quarter was considerably higher than in 1951, due primarily to massive exports to sterling area countries made before the imposition in these countries of severe restrictions against all imports of consumer goods. Comparing the last three quarters of 1952 with the corresponding period of 1951 we find that the

decline in the volume of exports was 11 percent instead of the 6 percent suggested by calculations based on a full year.

Another characteristic of the decline in exports during the last three quarters of 1952 is that it was due entirely to the decline in exports to the sterling area. Exports to most other areas during that period were only slightly below their 1951 level in terms of volume. This is a tentative conclusion based on data for the period April-October 1952 since regional breakdowns are not yet available for November and December 1952, but it is unlikely that returns for these two months will alter the picture significantly:

	Million £		
	Year 1951	April-October 1952 (Annual rate)	Change
Dollar area	326	339	+ 13
Sterling area	1313	1143	- 170
OEEC	614	630	+ 16
Latin America	112	101	- 11
Other	215	219	+ 4
Total	2570	2432	- 148

What is the significance of these developments for the future of British exports to non-dollar markets?

1. The sharp drop in exports of textiles in 1952 was due not only to import restrictions in foreign countries but also to a world-wide decline in demand following the excessive buying of 1951. It is reasonable to expect that as foreign demand revives exports of British textiles will recover from the low point reached in 1952. A return, however, to the levels of 1951 appears unlikely in view of receding inflation in foreign countries and increasing Japanese and German competition. The same considerations apply to most other consumer goods. It follows that an increase in British exports above the levels of 1951 seems to depend on an increase in exports of metal goods, machinery, chemicals, coal and

new industrial products which will be in demand in world markets. Such an increase, however, will require an expansion in productive capacity and manpower in the British heavy industries which will take time to be achieved. Thus there is no prospect that British exports will soon resume their rapid postwar expansion.

2. In the postwar period over 10 percent of total British exports served to finance the repayment of sterling debt and the export of capital to sterling area countries. It is clear that so long as a country is willing to place at the disposal of others funds which can be used only for the purchase of its own goods there is no limit to the increase in its exports which it can achieve by this means. The purpose, however, of exporting, especially in a period of full employment, is to earn the means of paying for needed imports. When a large proportion of exports serves other purposes the result is bound to be a weakening of the country's external position, however high the volume of its exports. Large "unrequited" exports weaken a country's economic position in four ways: (i) they divert resources which could have been used at home to meet local demand for goods and improve the country's productive equipment; (ii) to the extent that they consist of goods for which there is no genuine demand either at home or abroad they help maintain a structure of production which has ceased to correspond to the country's needs; (iii) to the extent that the goods involved could have been sold to other markets against cash, unrequited exports reduce the country's ability to finance its import needs; and (iv) by making sales easy in sterling area markets unrequited exports tend to divert goods from hard currency markets and hence to increase the country's external difficulties.

In the postwar period Britain has experienced all these consequences of large unrequited exports and this is one of the reasons why the large increase in British exports achieved in the postwar period has not contributed as much as could have been expected to the restoration of equilibrium in her external accounts. Present indications are that the policy of large capital exports to the sterling area will be continued but that more attention will be paid to the utilization that is made of the funds thus supplied. The communique of the recent Commonwealth Conference states that "the United Kingdom Government are determined that the flow of capital from London for sound development throughout the Commonwealth shall be maintained and increased". It is added, however, that highest priority will be given to schemes that will contribute to the improvement of the sterling area's balance of payments. This inevitably means that there must henceforth be more emphasis on primary production and less on industrialization. There is, however, no evidence yet of any intention to set up machinery for the screening of projects. Until now capital has flowed quite freely to the rest of the sterling area without regard to the purpose for which it was moving out of Britain. In the postwar period exports of capital to the sterling area have averaged between £150 and £200 million a year. The Commonwealth communique seems to indicate that the intention is to maintain, if not increase, that rate in the coming years. To the extent that the decision to concentrate on dollar-earning or dollar-saving projects is implemented, these exports of capital will gradually strengthen the sterling area's balance of payments and hence Britain's external position. But even in that case, no quick relief can be expected for Britain as the projects in question will take time to yield results. If, on the other hand, capital exports continue to be made in the present haphazard way there will not even be this

promise of future reward.

With regard to sterling balances, in spite of large postwar repayments to certain countries there have been large accumulations by other countries so that, on balance, outstanding liabilities are still very considerable:

	Million £		
	31st December 1945	30th June 1950	30th June 1952
Sterling area countries			
Dependent territories	446	580	1,042
Independent countries	2,007	1,917	1,513
Non-sterling area countries			
OEEC countries	409	378	349
Other (mainly Egypt)	801	596	493
Total	3,663	3,471	3,397

A current view is that at their present level sterling balances, even though large in themselves, are no longer a serious threat to Britain's external position. This view is based on the following considerations:

(i) The composition of the sterling debt has greatly changed since 1945: at present 30 percent of sterling balances are held by dependent territories compared with only 12 percent in 1945. Of the total of £1,042 million thus held by dependent territories in June 1952 one third represented the cover of their currencies and was not therefore available for spending. Another small part was needed for working balances. Thus no more than £600 million are considered to be likely to require repayment by Britain at some time. Britain, moreover, exercises sufficient control over the policies of these territories to be able to determine the rate at which these sums will be spent and hence to minimize the strain which their utilization might impose on her economy. It has even been argued that these balances are more in the nature of

an internal than of an external debt since a large part of them is held by British nationals. 1/

(ii) Before the war short-term foreign claims on London, held as reserves and working balances, totalled £700 million. Taking into account the rise in sterling prices this sum corresponds to some £2,200 million of current sterling. This means that of the total of £3,400 million of sterling balances in June 1952, only £1,200 million are likely to require repayment in the coming years and of this, as already stated, a large part belongs to colonial territories and is therefore under British control. Definite commitments have already been made towards India, Pakistan and Ceylon, i.e. the Colombo Plan countries, for releases of £345 million by 1957 and towards Egypt for releases of £140 million by 1960. In view of these facts, it is said, it seems reasonable to assume that releases of sterling balances will not require more than £100 million per annum in the next decade. What is more, the liquid form in which these balances are held is no longer likely to constitute a threat to the stability of sterling since the largest part of these balances will be held as reserves and will not therefore be available for spending.

In our opinion, this appraisal of the problem of sterling balances is unduly optimistic for the following reasons:

(i) Even if the dependent territories abstain from utilizing any sizeable part of their sterling balances in the coming years, which seems doubtful, the fact that these territories are unlikely to continue accumulating

1/ See A.R. Conan, The Sterling Area, p. 140: "A detailed analysis of these balances seems to show that insofar as they represent backing for colonial note issues, they do not constitute an overseas loan to the United Kingdom, while insofar as they represent the sterling funds of banks operating in colonial territories they are the property, not of Colonial Governments, but of such banks: few of these banks would be in colonial ownership.... it appears that a very large part (perhaps much the greatest part), of the sterling balances of the Colonies does not in fact add to the United Kingdom's external liabilities."

sterling claims means that the releases that will be made to other areas in the coming years will no longer be offset by accumulations on the part of the dependent territories and hence will be more burdensome on Britain than they have been in the last three years.

(ii) Before the war foreign countries were willing to hold a large part of their reserves in sterling because sterling was a convertible currency The fact that sterling has become an inconvertible currency subject to recurring crises has seriously impaired the usefulness of sterling balances as reserves. Calculations based on the prewar size of sterling balances are bound to exaggerate the amounts that foreign countries are likely to want to hold as reserves rather than spend.

The significance of these considerations is three-fold: first, they suggest that the drawing down of sterling balances in the coming years is likely to be substantial; second, they suggest that many holders of sterling balances will continue looking for opportunities to convert their sterling into dollars; and third, they suggest that the existence of this large amount of sterling claims held in such a highly liquid form will remain a threat to the stability of sterling, especially during periods of difficulties and crises.

Our conclusion is that unless there is a drastic change in policy in the coming years, large unrequited exports to the sterling areas are likely to remain a feature of British foreign trade and to continue imposing a serious strain on British resources and on the British external position.

3. An increase in exports to other non-dollar areas, which means primarily the OEEC countries and Latin America, can be achieved only if Britain increases her imports from those areas. The only other ways to sell more goods in these areas would be to extend credits or receive payment in hard currencies. Extending credit means making "unrequited" exports, which, as already stated, weaken instead of improving a country's external position. Expecting payment in dollars from areas which themselves suffer from an actue shortage of dollars would be equally futile.

In view of this close relationship between exports to and imports from those areas, restrictions on imports are justified only to the extent that they are needed to correct a deficit or repay a debt. Restrictions maintained in the hope of achieving a surplus in trade with these areas are bound to prove self-defeating since they can only succeed in creating a shortage of sterling in these areas and hence in forcing them to curtail their imports from Britain. Recent trends in British trade with the non-dollar countries of Latin America illustrate this relationship. The sharp decline in British imports from these countries which took place in 1952 has been accompanied by a steady decline in British exports to these countries:

	Million £	
	British imports from non-dollar Latin America	British exports to non-dollar Latin America
1st quarter 1952	31.7	29.4
2nd " "	23.5	29.0
3rd " "	18.5	22.6
October "	8.4	7.3

Similarly the recent British surpluses with OEEC countries following the imposition of severe restrictions on imports from Europe cannot be maintained without forcing OEEC countries to adopt similar restrictions on imports from Britain.

In the case of Latin America, it is true that the low level of British imports from the area is due as much to the currency overvaluation and other unsound economic conditions prevailing in the area as to British import restrictions. There can, however, be no doubt that a higher volume of exchanges with the area would have been possible if greater efforts had been made to overcome the existing obstacles.

4. Our overall conclusion from the preceding discussion is that Britain's ability to increase, or even maintain, her "requited" exports to non-dollar markets in the coming years will depend on her ability to provide the goods needed in these markets, which will increasingly be heavy industrial goods, and on an expansion of her imports from these areas. The task will become more difficult than it has been in the recent past due to increased competition from Germany and Japan. The widely expressed fear that the reappearance of Germany and Japan in world markets may cause a severe contraction in British trade is no doubt exaggerated: given high levels of economic activity in the world there will be ample demand for the products of all countries if these products are suited to the existing needs and are offered on competitive terms. There is no reason to think that British industry will be unable to meet these requirements given sound economic policies in Britain and in the sterling area. If, on the other hand, there is a world-wide decline in economic activity, Britain, the center of a vast Commonwealth, should be in a stronger position to maintain her trade than either Germany or Japan. It is nevertheless true that the

recovery of these former enemies has made the British position in world trade less favorable than it was in the first postwar years on two counts:

(i) It has affected adversely Britain's prospects of maintaining her sales of goods for which before the war Germany and Japan had been principal suppliers but which they were unable to provide in the immediate postwar period, thus allowing Britain and other industrial countries to capture their former markets.

(ii) It has increased both the supply of industrial goods and the demand for primary products in the world and hence caused a further unfavorable shift in price relationships between industrial and primary products. This factor accounts in part for the steady deterioration in Britain's terms of trade since the end of the war and suggests that the recent improvement in terms of trade is unlikely to continue. 1/

In the light of the preceding considerations it seems reasonable to conclude that even with regard to non-dollar countries the task of maintaining a high volume of trade and of balancing external accounts will not be easy and will require some fundamental adjustments in British policies and in the British economic structure. It seems also reasonable to conclude that the cost of imports in terms of exports will continue to be much higher than before the war and to absorb a much greater proportion of British resources.

1/ British Terms of Trade
(Ratio of import prices to export prices)

	1947 = 100
	1948 = 102.2
	1949 = 101
	1950 = 108.7
	1951 = 122.8
1st half	1952 = 117.5
October	1952 = 110.5

III. The Internal Improvement and its Significance

As already stated, the data necessary to determine the nature and extent of the imrpovement which took place in the internal situation during 1952 are not yet available, but the reality of the improvement cannot be seriously questioned.

The test of internal stability is the stability of the price level. In this respect the picture in 1952 has been almost as good as in the United States, where, as is well known, a considerable degree of price stability has been maintained since the middle of 1951. Between April and November 1952 1/ British retail prices increased by 2 percent and wage rates by 4 percent while wholesale prices declined by 2 percent and export prices by 4 percent. This compares as follows with developments in the corresponding period of 1951:

	Changes between April and November Percent	
	1951	1952
Wholesale prices	+ 3	- 2
Retail prices	+ 6.6	+ 2
Wage rates	+ 6.8	+ 4
Export prices	+10.4	- 4

This improvement was the more remarkable as it occurred in a period of lower production, larger budgetary deficits and cuts in the import program.

As already stated, during the period April-September 1952 industrial production declined by nearly 7 percent compared with the corresponding period of 1951. If, however, we include the first quarter of 1952, when production was at its highest postwar level, the decline was much less, only 4 percent. In trying to determine the size of the resources available in 1952 as against those

1/ The last month for which data are available.

available in 1951 the latter is clearly a more significant comparison.

The following table shows that the decline in production was not uniform, it was heavily concentrated in the textile and other consumer goods industries. There was no decline in the heavy industries or in public utilities and there were increases in food manufacturing and in building materials:

	Period January-September 1951 (1948=100)	1952	% Change
Decreases			
Textiles 1/	120	92	-25
Clothing	118	101	-15
Leather and manufactures 2/	103	83	-20
Chinaware	113	107	- 6
Paper and printing	138	120	-13
Glass	119	106	-11
Miscellaneous manufactures 2/	123	108	-13
No Change or Small Change			
Mining	106	107	
Metals, engineering, vehicles	121	121	
Drink and tobacco	96	97	
Chemicals 1/	131	129	
Gas, electricity, water	121	122	
Increases			
Food	108	113	+ 5
Bricks, cement, etc.	113	120	+ 6
Building	101	103	+ 2

1/ January-August
2/ January-July

The decline in the production of textiles and other consumer goods is accounted for largely by the decline in exports but there was also a fall in domestic consumption and a decrease in stocks. Estimates of personal expenditures suggest that during the period January-September 1952 expenditures on clothing, expressed at constant prices, were 7 percent lower than in the corresponding period of 1951, and expenditures on household goods 12 percent lower. During the same period wholesalers' stocks of textile goods are estimated to have declined by 30 percent. The lower sales of these two categories of consumer

goods appear to have been due to the reaction of the public against high prices as well as to earlier over-buying. It is significant that the only retail prices that declined in 1952 were the prices of clothing and household durables.

The consumption of other goods and services remained practically unchanged in 1952 but the lower consumption of clothing and household goods reduced the overall level of consumption by 2 percent:

	Million £ Personal Consumption Expenditures Expressed at 1948 Prices January-September		
	1951	1952	
Food	1758	1761	+ 3
Alcoholic beverages	549	534	- 15
Tobacco	576	586	+ 10
Rent and utilities	777	781	+ 4
Travel and entertainment	399	396	- 3
Clothing	514	477	- 37
Footwear	115	104	- 11
Household goods	460	404	- 56
Other goods and services	1301	1282	- 19
Total	6449	6325	-124

The fact that this slight decline in consumption was concentrated in only two categories of goods strongly indicates that it was the result of a free choice of consumers and not, as has been suggested, of a decline in purchasing power due to the rise in prices. There is no evidence that total money income failed to keep pace with rising prices: In both 1951 and 1952 wage rates increased as much as retail prices and profits, by definition, rose at least as much as prices. The rise in prices no doubt curtailed the purchasing power of persons with fixed incomes but the fact that, although these persons belong largely to low income groups, expenditures on such relatively non-essentials as tobacco, drink and entertainment were maintained, seems to indicate that the decrease in the purchasing power of certain sections of the population which may have taken place in 1952 had no significant effect on overall consumption.

Our assumption that real incomes were maintained in 1952 implies that the 2 percent decrease in consumption resulted in an increase in savings. Data

on savings do not seem to bear this out. The total of savings outstanding in September 1952 was slightly lower than at the beginning of the year:

Million £

	1951 January	1951 September	1952 January	1952 September
Post Office and Savings Banks	2,851.7	2,799.5	2,806.0	2,784.4
National Savings Certificates	1,678.5	1,723.3	1,723.3	1,720.2
Government Securities on Post Office Register	1,115.1	1,110.6	1,088.5	1,032.6
Total	5,645.3	5,633.4	5,617.8	5,537.2

On the other hand, time deposits (deposit accounts) in the banks increased considerably during that period:

	Million £
January 1951	2,078
September 1951	2,067
Change	-11
January 1952	2,031
September 1952	2,216
Change	+ 185

This corresponds very closely to the decrease in consumption which occurred during that period. 1/

The fact that the decrease in consumption is reflected in an increase in bank deposits rather than in increases in other forms of savings may be significant since it may mean that what happened in 1952 was a postponement of spending rather than a decision to consume less.

Another significant development may be the fact that food consumption showed no decrease until September 1952 in spite of the very large cuts in

1/ Expressed at current prices, consumption increased from £7,305 million in January-September 1951 to £7,662 million in January-September 1952. The fact that in real terms consumption declined by 2 percent implies a price increase of some 7 percent. Our assumption that real income did not decline means that total purchasing power available for spending was £7,810 million (i.e. £7,305 million increased by 7 percent to take account of the rise in prices). The difference between this figure and the actual spending of £7,662 million, i.e. £148 million, must be compared with the £185 million increase in deposits minus the £80 million decrease in savings which occurred during that period. Taking into account the highly approximate nature of the estimates, the correspondence must be considered as very close.

food imports decided upon in 1952. This may mean that the effects of the cuts had yet to be felt in the economy.

The conclusion that emerges from the preceding discussion is that the decrease in inflationary pressures in 1952 has not been due to a decrease in consumption. The slight decline indicated by available estimates has been wholly due to the decline in consumption of textiles and household goods which, however, was matched by a decline in production and did not, therefore, serve to release resources for other purposes.

Of the other two categoriesof expenditures, i.e. Government spending and investment, the former, as already pointed out, increased considerably during this period without a corresponding increase in revenue and was therefore a strong inflationary influence in the economy. The budgetary results of the first nine monthsof 1952 which we have quoted earlier suggest that there was a deterioration in the fiscal picture of some £400 million. Since the full effect of the higher taxes decreed in March 1952 was due to be felt only in the last quarter of the fiscal year, the real inflationary impact of Government finances on the economy was not as great as this £400 million deterioration suggests, but it must have been at least equal to half this sum.

Since neither consumption nor government spending account for the internal improvements, the greater stability of the economy in 1952 must have been due to lower investment expenditures. Information on the size and direction of investment in 1952 is not yet available but we have seen that the Government envisaged a reduction in both fixed investment and stocks.

The fact that exports of metals goods increased during 1952 while production remained stationary would seem to indicate that there was a diversion of equipment from home investment to exports. This evidence is, however, too indirect and the increase in exports was not large enough to allow any definite conclusionsto be drawn from it about the size of fixed investment in 1952. On

the other hand, we have seen that new borrowings increased sharply in 1952.

Critics of the Government have complained that while capital expenditure in productive industry was "being cut to the bone", the Government "failed to keep any check" on its own investment, especially housing. 1/ On the whole it would appear that, even if the decrease in fixed investment envisaged by the Government did take place, it cannot have been an appreciable factor in the greater internal stability attained in 1952 and was probably less than the £100 million forecast at the time of the Budget.

This leaves changes in stocks as the only possible important anti-inflationary influence in the economy during 1952. That this has been the principal factor in the greater stability of 1952 is suggested by the fact that while during 1951 the physical increase in stocks amounted to £387 million 1952 has been a year when stocks were drawn down substantially. No data on the extent of the decrease in stocks are yet available for 1952 but there can be no question that such a decrease has taken place. We have seen that at the time of the Budget the Government had assumed that stocks would decline by £150 million in 1952 and had announced that this drawing down of stocks would be one of the principal means of offsetting the inflationary pressures in the economy. In addition to this more or less planned reduction in stocks which was expected to result from a reduction in imports, falling prices and demand induced traders and manufacturers to let their stocks of materials and finished goods decline and to postpone their replenishment. This was particularly true of textiles where, as already stated, wholesalers' stocks declined by 30 percent. During 1950, when there was also a drawing down of stocks, the decrease in stocks is estimated to have amounted to £168 million, and it must be remembered that in 1950 there was no falling market, and hence no liquidation

1/ See Economist, October 4, 1952, p.48.

of stocks by traders and manufacturers.

Taking all these considerations into account we may conclude that the decline in stocks in 1952 is not likely to have been less than £150 and may have been as high as £200 million. This means that, while in 1951 resources equal to £387 million were devoted to stock-building, in 1952 this drain on the economy disappeared and in addition resources of some £150 to £200 million were made available from accumulated stocks. Thus the shift from stock-building to stock-depletion may have freed over £500 million of resources for other purposes, thereby relieving the strain imposed on the economy by larger defense expenditures and lower imports.

The fear has been expressed that this is a repetition of the familiar British postwar expedient of "living off stocks until the next balance of payments crisis comes along". 1/ In the absence of information, it is impossible to determine to what extent the fear is justified but it is significant that when the demand for textiles revived in the fall of 1952 the depletion of stocks was found to have been so great that an actual shortage of goods developed in certain lines. 2/

If our interpretation of internal developments in 1952 is correct, it suggests the following conclusions with regard to the prospects for the coming years:

The improvement of 1952 owes so much to the shift from stock-building to stock-depletion, which is of a non-recurring character, that it cannot be considered as decisive. There are several reasons for believing that British resources and the British price level will continue to be subjected to considerable pressures in the coming years:

1/ See Economist, September 13, 1952, p. 642.
2/ The Times Annual Financial and Commercial Review, London, October 13, 1952, p. xx.

(a) From now on increases in production will be small. Expectations of a rapid growth of productivity do not seem justified.

(b) If external balance is to be maintained, the supply of imported goods will have to be smaller or exports larger than in 1952.

(c) Defense spending, even if it does not rise above the level of 1952, is unlikely to decrease significantly in the coming years.

(d) Productive investment must be maintained, if not increased, if British productivity is to improve and Britain's competitive position in the world is to be maintained.

These considerations suggest that there will be no room for a rise in consumption in the coming years. The pressure for wage increases will, however, continue. We have seen that during the postwar period, in spite of strong Government exhortations and considerable restraint on the part of trade unions, wage rates have been steadily rising. The pressure could be eased only through a degree of disinflation that would create sufficient unemployment to act as a stabilizer in the economy. Such a course has been strongly advocated but is highly improbable. All indications are that conditions of full employment will be maintained in the economy in the coming years. If there were any doubts on this matter, public reaction to the recent textile slump should have dispelled them. The temporary and wholly localized increase in unemployment resulting from the slump [1] caused so much concern in both

1/ Unemployment rose as follows in 1952:

	Thousands			
	Total	Textiles	Miscellaneous Manufacturing	Other
January 1951	367	13	21	333
May 1951	241	10	14	217
November "	323	41	22	260
January 1952	426	70	30	326
May "	519	161	38	320
November "	450	43	32	375

This table shows that between May 1951 and May 1952 unemployment increased by 278,000 and of this total textiles and miscellaneous manufactures accounted for 177,000. It should be noted that as a percentage of the total civilian labor force unemployment has remained low throughout the period: Percent of total civilian labor force: May 1951, 1.0, May 1952, 2.3, November 1952, 2.0.

political parties and among all sections of the population that the Government was forced to intervene with measures, such as the reduction in purchase tax on clothing and the stepping up of military orders for textiles, which were bound to affect adversely the already weak budgetary situation. The problem of maintaining wage and price stability under conditions of full employment, which exists in all countries, is made still more difficult in Britain by the fact that food subsidies, which have kept the cost of living at an artificially low level in the postwar period, will have to be eliminated if a realistic price structure is to be restored. The 40 percent reduction in food subsidies undertaken in 1952 was the first step in this direction and, although it was made with the utmost skill and care, it did strengthen the pressure for wage increases.

Our conclusion is that British resources and the British price level will continue to be subjected to a serious strain in the coming years and that the improvement of 1952 will appear in retrospect to have been a breathing spell rather than the end of British postwar difficulties.

There is only one factor which can alter significantly this prospect and this is a change in the behavior of business and consumers. Throughout the postwar period inflationary pressures were made worse by the inflationary psychology which they themselves generated. The expectation of inflation itself produced inflation. The year 1952 is significant in that it was the first time since the war that losses were sustained because inflationary expectations were not borne out. This may prove to have been a turning point in the postwar economic picture. The end of the inflationary psychology would mean greater caution on the part of businessmen and a greater willingness to save on the part of the public and there can be no doubt that the resources that could be released in this way would be considerable. It is clear,

however, that this change in psychology can make its contribution to the solution of Britain's difficulties only to the extent that the country's policies are not inflationary, and this means that the need for restraint and vigilance will remain as great as ever.

IV. The Role of Monetary Policy in the Recent Improvement

The contribution which the monetary measures described in an earlier section have made to the recent British economic recovery is at the present the subject of heated debate in economic and business circles.

Monetary policy enthusiasts are inclined to give to these measures the major credit for the greater stability attained in 1952. They argue that, externally, the post-Budget rise in interest rates, by forcing the liquidation of short positions in sterling, has been a principal factor in the inflow of funds which has contributed so greatly to the external improvement. In support of this view they point to the dramatic recovery in the dollar accounts after March 1952 which coincided with the rise in interest rates. 1/ Internally, they say, the fall in Bank advances which has been the major disinflationary factor in 1952, has been the direct result of the tightening up of credit, including consumer credit, which has been induced by higher interest rates and lower Bank liquidity. Similarly, more costly credit has had a restraining influence on

1/ The gold and dollar deficit, exclusive of American aid, declined as follows since the Budget:

	Million $	
1952	EPU Settlements	Other Gold and Dollar Balance
January	-75	-224
February	-94	-172
March	-50	- 21
April	-51	- 12
May	-45	- 20

investment. Finally, the sharp decline in security prices caused by the rise in interest rates has made the holders of such securities, including the banks, reluctant to sell and has thereby curtailed an important source of spendable funds.

The fact that the new policy has not been able to reduce the volume of money and the total volume of credit and investment is attributed to the laxity of the Government's budgetary policy and to the extravagance of its housing program and it is argued that, if the Government had not offset the contraction in bank advances and in private investment by its own large borrowings, the new policy would have been able to administer a really strong dose of disinflation to the economy.

The critics of monetary policy deny that the rise in interest rates has been of any great significance and maintain that the improvement of 1952 has been due to entirely different factors.

The cessation of speculation against sterling following the Budget, they point out, resulted from the realization that the crisis would be tackled with determination and not from the higher cost of bank credit. It is true that the sharp decline in acceptance business which occurred in 1952 contributed to the improvement of the external position, but higher rates of interest have been only one factor in this decline. Tighter government regulations and the fall in commodity prices and in foreign trade have been much more important in causing the decline. 1/

1/ The Times Annual Financial and Commercial Review, London, October 13, 1952, p. Xi, describes the developments in the field of acceptance business as follows: "The maximum period normally permitted for usance drafts drawn under credits on U.K. banks or acceptance houses was reduced from 120 days to 90 days. An official ban was placed on refinancing operations by which means buyers outside the sterling area had been able to protect their exchange position and at the same time to finance their business purchases at the low rates still obtaining in this country. Commodity prices had in many cases fallen considerably from the high levels of 1950-51.....And then .....other countries.....put hurried restrictions on further imports and

With regard to Bank credit, the critics of monetary policy argue that the application of stricter criteria of lending requested by the Government and loyally adhered to by the banks, together with the caution and hesitancy induced by falling commodity prices and demand, have been much more important factors in bringing about the decline in bank advances which occurred in 1952 than the higher cost of borrowing. In support of this view they point to the fact that the bulk of the decline in advances occurred in four categories: textiles, food, public utilities and personal, where factors other than interest rates have been at work in reducing borrowing:

	Million £	
	Change in Bank Advances	
	February-November	
	1951	1952
Textile industries	-	- 37.4
Food, drink, tobacco industries	+ 36.7	- 29.4
Personal and professional	+ 5.2	- 51.9
Public Utilities	+ 38.4	- 38.4
Other	+129.1	- 83.3
Total	+209.4	-240.4

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trade with those centres was stopped almost overnight. Over and above all this bill rates had risen here from 1% for prime three months' bills in October 1951 to 3% in March 1952. Bills no longer represented an ultra-cheap form of finance and that fact alone could lead to a considerable reduction in the volume coming forward. The acceptance houses have, therefore, seen a big diminution in the amount of bills passing through their hands during the year. This drop may be as much as one-third. Many of the factors responsible are non-recurring; some may be temporary and some seasonal; but it would appear that, other things being equal, the peak figures of 1950-51 will not again be reached for a considerable time."

The principal cause of the decline in advances to textile industries was obviously the slump in the prices and sales of textiles. Similarly the decline in advances to food industries must have been due to causes other than higher interest rates. The decline in personal and professional loans was due to the pressure which the banks, carrying out the Government's instructions to reduce lending for non-essential purposes, exerted on their borrowers. The decline in advances to public utilities represents a repayment of an advance made in 1951 to the British Electricity Authority. The repayment was made out of the proceeds of a public issue, the largest part of which had to be taken up by the Government itself.

With regard to long-term investment, the critics of monetary policy argue that those investments which are most sensitive to interest rates, namely, housing and public utilities, are at present insulated by the Government from the effects of monetary policy. Thus, they point out, during the last year the Government has offset the effect of higher interest rates on housing by means of a larger subsidy; it has lent £60 million to the British Transport Commission at 1-3/4% for 12 months and, as already mentioned, it has supported £100 million of the £150 million British Electricity Authority Issue by departmental underwriting.

Private investment has undoubtedly been affected by the rise in interest rates, but it has also been affected by the tightening up of government controls so that it is incorrect to attribute any decrease in private investment which occurred in 1952 to the new monetary policy alone. The advocates of monetary policy, it is argued, in their enthusiasm for this form of regulation of the economy tend to forget the realities of present British conditions. The extent to which direct government controls dominate the field of private investment has been described as follows in a recent discussion:

"It is now extremely difficult to get a license to build a factory or to use steel for constructional purposes. Furthermore, when an industrialist wishes to finance an installation of plant and equipment with borrowed money, the Capital Issues Committee can prevent the fulfillment of his plans if the government departments, on whose advice the Committee acts, do not consider that the particular project is in the national interest at the present time. And now that there is an official ruling against borrowing from the Banks for the purpose of financing investment in fixed assets, it is no longer possible to evade the government control on capital issues by using bank borrowings instead." 1/

Finally, it is said, to the extent that the new monetary policy does succeed in discouraging industrial investment, it will be making the wrong contribution to British recovery since what Britain needs in order to recover is more, not less, industrial investment. The idea of a permanently low volume of industrial investment as the answer to Britain's difficulties is considered so preposterous that it has been said, partly of course in jest, that the Government's new monetary policy "is not the traditional monetary policy but is simply something temporarily forced on them by the shortage of steel." 2/

It is too early to appraise conclusively the effects of the recent British monetary measures but certain things are already reasonably clear:

The announcement of the increase in Bank rate from 2½ to 4% undoubtedly made a deep impression on the markets and was widely interpreted as evidence that the new government was determined to use the most drastic measures in order to restore health to the British economy. But there can be

1/ Bulletin of the Oxford University Institute of Statistics, August 1952, p. 266.
2/ Bulletin of the Oxford University Institute of Statistics, August 1952, p. 280.

little doubt that this reaction was based more on memories of what a rise in Bank rate had meant in the past than on a sober appraisal of what it could do under present British conditions.

The traditional effectiveness of Bank rate as an instrument of monetary policy did not lie in the actual effect of a rise in interest rates on the profitability of business but on the understanding that, in a crisis, Bank rate could be raised, and go on being raised until it did exercise a sufficient effect. "The possession of this reserve power," it has been pointed out, "was the real strength of the Bank; as people became accustomed to the knowledge that the reserve power existed, it rarely required to be exercised. Quite a small rise in Bank rate was taken as a signal; and a signal was enough." 1/

Conditions today are different in two important respects: In the first place, the existence of a large unfunded public debt precludes rises in interest rates that would increase significantly the burden of the debt: "The Treasury is bound to resist rises in Bank rates which will aggravate its budgetary problems; Parliament is bound to resist the handing out of taxpayers' money to financiers and rentiers." 1/ In the second place the adjustments that are needed to restore balance in the British economy are of an entirely different order of magnitude from those that had to be made from time to time during the days when Bank rate was the major instrument of economic policy.

That Bank rate can no longer have the corrective effects which in the past were associated with it is bound to become apparent in the course of time. This means that the psychological impact of the March announcement and its undoubted success in creating a new, less inflationary climate in the economy, were once-for-all gains which similar announcements in the future are unlikely

1/ Bulletin, op. cit. p. 269.

to produce, assuming that a further increase in Bank rate would be contemplated, which seems improbable. Moreover, the fact that the rise in Bank rate coincided with a period of falling commodity prices and world-wide stabilization makes it difficult to determine how much of the business caution which developed in 1952 and contributed so greatly to the disinflationary atmosphere of that year is attributable to the psychological impact of Bank rate and how much to the change in the world economic outlook.

In the light of these considerations the claims of monetary policy enthusiasts on behalf of the monetary instrument and of its contribution to the recent improvement of the British position appear exaggerated. If our interpretation of the British position is correct, the basic difficulties facing the British economy have still to be solved. The claims of the advocates of monetary policy must be judged by the test of whether monetary policy can play a major role in solving these difficulties. There can be no doubt that a severe enough degree of monetary contraction could, in a very short time, restore both external balance and internal stability, but it could not do so without at the same time creating severe unemployment. In fact, it is only through the creation of unemployment, that most effective of stabilizers that monetary contraction can achieve its purpose. It is clear that even if it were desirable to reduce the level of employment in Britain, which it is not, such a course would not be acceptable to the British public. This inevitably means that the contribution which monetary policy can make to the solution of the complex problems facing the British economy is strictly limited.

This is not to say that the recent increases in interest rates were unjustified. On the contrary the increases were over-due and have supplemented the other measures taken to deal with the crisis. A cheap money policy is clearly inconsistent with the present strain on British resources and is

bound to be inflationary unless the economy were subjected to a still greater degree of control and regimentation. The cost of borrowing may not be the major factor in business decisions but it is one of the factors, especially in marginal cases, and in Britain, where resources are so strained, such marginal cases may make the difference between inflation and stability. Nor were the recent rises in interest rates such as to justify the contention that they will adversely affect the country's industrial development. 1/ But to call these necessary increases in interest rates a rediscovery of monetary policy and a return to monetary orthodoxy is an exaggeration. Moreover, the Government's subsequent actions have clearly demonstrated that there was no intention to make any drastic departure from the policies evolved in the postwar period.

1/ Present levels of interest rates are as follows:

	Yields	
	October 1951	November 1952
British Government Securities		
Short-dated	1.70	2.88
Medium-dated	3.66	4.18
3½% War Loan	4.06	4.48
2½% Consols	3.81	4.16
Industrial Securities		
Debentures	4.33	4.82
Preference shares	4.94	5.46
Ordinary shares	5.26	6.46

Yields on real property are estimated to have increased from 4½% - 5% to 6%. Rates on mortgages increased from 4 to 4½%. No information is available on interest rates on Bank advances.

D. CONCLUSIONS

It has been a feature of the British postwar economy that, every time the external position improved, restrictions were relaxed and hopes for an early restoration of convertibility revived. The recent improvement is no exception to this pattern. The fact that the communique of the latest Commonwealth Conference contains references to the restoration of sterling convertibility as "an integral part of any multilateral system" and as an objective that can be reached "by progressive stages" has been widely interpreted as an indication that steps in this direction have been seriously discussed at the Conference and may soon be put into operation.

The wording of the communique suggests that an attempt will be made to secure financial support through the International Monetary Fund or through an American stabilization credit. The impression is also widely prevalent that any move towards convertibility will be combined with greater flexibility of exchange rates. In fact, it is reported that there was general agreement at the Conference that there can be no question of re-establishing convertibility of sterling on the basis of a fixed parity.

Another impression is that, whatever is done about convertibility, there is no intention of dismantling the present discriminatory import restrictions against dollar goods. Finally it is reported that, before embarking on a convertibility venture, Britain intends to seek undertakings from important non-dollar countries that, as and when sterling becomes convertible, they will not so conduct their trade as to accumulate sterling for the precise purpose of converting it into dollars. There is also the suggestion that European countries might be sounded about joining in the convertibility experiment.

All these, however, are mere guesses and there are wide discrepancies between them. Some reports give the impression that the Commonwealth plan

merely envisages consultations with the United States on how to expand the supply of dollars to the world, with the restoration of convertibility as an ultimate objective. Other reports suggest that a plan for a limited form of convertibility may be put into operation at an early date independently of American decisions.

The importance and urgency attached to this aspect of the British economic problem arises from the conviction that only when convertibility is restored will confidence in sterling be firmly established and the ghost of recurrent crisis be finally laid. It is also pointed out that the size of the dollar losses suffered since the end of the war as a result of periodic lack of confidence in sterling has been so great that it would probably not have been exceeded under conditions of convertibility. Britain, it has been said, has borne the cost of convertibility without its benefits since she has in fact converted large amounts of sterling into dollars while its currency continued to bear the taint of inconvertibility. It is therefore concluded that, given an adequate reserve to inspire confidence and given fluctuating exchanges to allow room for maneuver to the monetary authorities, sterling convertibility could be maintained without undue cost in dollars, to the immense advantage of both Britain and the rest of the world.

In our opinion, this approach disregards the realities of the British as well as the world situation.

In the first place, as already pointed out, the present British dollar balance is of the most precarious kind and in no way signifies that Britain has achieved real equilibrium in her dollar accounts. Our analysis of British economic developments since the end of the war has shown that all the postwar dollar crises occurred during periods when import restrictions had been relaxed and the control of inflation had weakened. In all cases it is only <u>after</u> the

deterioration in the current account had assumed serious proportions that adverse capital movements magnified the crisis. The existence of a large reserve is no guarantee that there will be no serious dollar deficits in the future. On the contrary the availability of a large reserve might reduce the urgency and weaken the incentive to take the (always unpleasant) corrective steps whenever such deficits develop. In that case no reserve will prove to be large enough to take care of Britain's dollar problem. It is said that a stabilization credit, if granted, would be granted on the understanding that it would be used as little as possible and would not therefore be exposed to this risk of early exhaustion. It is clear that if Britain is to honor such an undertaking, both she and the rest of the sterling area will have to watch their external accounts and their internal position much more carefully than they have done up till now. In that case, however, those sudden deteriorations which cause a world-wide distrust of sterling will not recur and hence the need to shore up confidence in sterling will not arise. The inadequacy of the present British reserves is real enough but it is not the cause of Britain's difficulties. If it were, the solution of these difficulties would be a relatively simple matter, which it is not.

In the second place, the "freeing" of the exchange rate which is said to be an indispensable condition for the restoration of convertibility would provide such an inducement to speculation that it would completely nullify the confidence in sterling that may be engendered by the restoration of convertibility. The knowledge that sterling is liable to slump as soon as pressure develops on the exchanges is bound to make speculators watch with eagle-eyed interest the British economic position and react with the usual over-sensitivity of speculators to any sign of weakness. Similarly, it is difficult to see how a currency whose value is subject to day-to-day fluctations can play the role of

a major world currecny which countrieswould be willing to hold and use extensively in their foreign transactions.

In "setting the exchange rate free" Britain would not only be taking a step which is unlikely to help her in her difficulties, she would also be going back on the obligation undertaken under the Fund Agreement to consult with other nations before altering the external value of her currency. The suggestion that the Fund Agreement could be amended to provide for a wider toleration of exchange fluctuations is a suggestion that would make the Fund entirely ineffective, since one of the main purposes in establishing the Fund was to make the determination of exchange rates a matter of international cooperation. The abandonment of this principle may mean that the 1950's will have to relearn the lesson of the 1930's, that independent national action on matters affecting other countries not only creates ill-will and suspicion between nations but is also self-defeating. 1/

In the third place, the restoration by Britain alone of dollar convertibility in a world starved of dollars is likely to put an unbearable pressure on sterling and force the abandonment of the experiment in a relatively short space of time. It has been estimated that in 1951 the countries that would benefit from sterling convertibility earned £3,200 million from their exports to Britain. It is clear that even if a small fraction of this sum were converted into dollars the burden would be beyond Britain's ability to bear. Arrangements with the countries concerned not to seek to accumulate pounds for conversion into dollars, if effective, would no doubt meet this difficulty

1/ Those who make the suggestion about wider exchange fluctuations do not specify the rate of toleration they have in mind. It is clear, however, that the significance of the proposal depends on the size of the fluctuations that it contemplates. A small widening of the present points would not be incompatible with the purpose of the Fund but it would also be unlikely to do the job of adjustment expected from it. Very wide points, on the other hand, are tantamount to complete freedom to alter the exchange rate.

but then convertibility thus hedged would be a mere formality.

Agreement by other major countries to follow sterling in the experiment of convertibility would reduce the danger of the whole impact of the world dollar shortage falling on Britain alone but there would still be the danger that each country would try to turn its holdings of other countries', currencies into dollars. Such an effort, made simultaneously by all countries, would obviously be self-defeating but, in the process, trade among those countries would shrink and all will be losers. Mutual undertakings not to seek dollars from each other would be a way of preventing this from happening but again convertibility under such conditions would prove to be an empty gesture.

In the fourth place, if Britain is to have the dollars that will be needed to implement a system of convertibility that is more than a mere formality, she will have to continue imposing the most severe restrictions on imports from the dollar area. This means that she will be depriving herself of urgently needed commodities in order to supply dollars to countries from which she would be obtaining less desirable goods and which might, ironically, be using these dollars to import luxuries from the dollar area.

So far, these aspects and implications of convertibility have received surprisingly little attention, but there can be no doubt that once the British public realize what, under present conditions, is involved in supplying dollars against sterling, support for the arrangement will wane fast. It is well to remember with what relief the public greeted the abandonment of the gold standard in 1931, i.e. at a time when the sacrifices involved were incomparably smaller than what would be required today by a return to convertibility.

However distasteful, the conclusion must be accepted that the conditions which made possible the convertibility of sterling before the war no longer exist: the dollar investments have been liquidated, gold buys only half

the goods it could buy before the war, imports are considerably more expensive in terms of exports, goods urgently needed are no longer obtainable outside the dollar area and there has been a social revolution, which, like all revolutions is proving costly and unsettling. Before sterling can be made convertible into dollars Britain must create either new sources of dollars or new sources of supply. Both are long-term as well as expensive propositions which, moreover, depend not only on British actions but also on the actions of the United States and of primary producing regions. Until these conditions are fulfilled, attempts to restore convertibility are bound to prove premature.

The fact that sterling cannot be made convertible into dollars does not, however, mean that it must remain a weak currency. If the necessary steps are taken, sterling could, before long, become again a sound and highly respected currency with all the attributes of a truly international means of exchange, save dollar convertibility.

In our opinion, the strengthening of sterling in the coming years will depend on Britain's willingness to do the following things:

(a) Prevent any further rise in British prices. A currency whose purchasing power steadily declines obviously cannot play the role of international means of exchange.

(b) Maintain a balanced external position vis-a-vis the non-dollar world at the highest possible level of trade. This will require a considerable increase in exports of heavy industrial goods, which in turn will depend on the expansion of production in the heavy industries. It will also require the abandonment of the idea that surpluses can be earned with these areas through import restrictions.

(c) Stabilize the flow of her imports and thus put an end to the postwar pattern of import expansion followed by import contraction which has not only

been a principal factor in the recurrent British crises but has also had a highly disruptive effect on world prices and world trade. It is the fashion in Europe to criticize the United States for the instability of its purchases of raw materials and to attribute the violent fluctuations of international commodity prices to this erratic American behavior. A glance at the British postwar performance will show that British purchases have been no less erratic in the postwar period.

(d) Improve the machinery of the sterling area to ensure better coordination of policies and closer cooperation on common problems. The degree of decentralization of decisions at present obtaining in the sterling area is clearly incompatible with the operation of a common reserve. Moreover, postwar experience shows that the existing machinery of consultation is both too slow and too cumbersome to anticipate events and prevent crises. It also shows that there is no machinery at all for coordinating investment and directing the flow of resources to those projects that would make the greatest contribution to the solution of common problems.

(e) Attain the highest possible degree of transferability of currencies within the non-dollar world with complete freedom of exchanges as the ultimate goal. The best way to do this would be to gradually expand the scope of the European Payments Union until all non-dollar countries become members.

(f) Work for a common approach by the non-dollar world to the solution of the dollar problem that would seek to maximize exchanges with the dollar area and would ensure that the efforts of individual countries to solve their dollar difficulties do not cancel out.

It is sufficient to enumerate the things that have to be done before the present weaknesses of sterling are overcome to realize that a mere technical device, such as declaring that sterling is convertible into dollars, cannot do the trick.

The fear that continued inconvertibility of sterling would divide the Western world into two rival and antagonistic blocks is unfounded. There can be no doubt that a unified world economy would be a far better alternative, but, until the United States decides to accept more of the world's products, such an economy will remain an unattainable objective. A return to non-discriminatory trade and currency convertibility on the basis of the present insufficient world supply of dollars would not expand trade with the United States, it would merely force the non-dollar countries to reduce their exchanges among thereselves to the low level of their exchanges with the United States.

The obstacles to the acceptance of this conclusion are largely psychological. Having convinced ourselves that a currency that is not convertible into dollars is an unsound currency, we are unable to see how anything less than full convertibility can work. Once it is recognized that there is no indignity in non-convertibility, provided a currency has a stable purchasing power, most of the difficulties in accepting the implications of the present international economic structure will disappear.

In this respect it is worth recalling that after the first world war, the objective of making it possible for the pound to "look the dollar in the face" became the major consideration of British economic policy. Disregarding the fact that the British price level had risen more than the American price level, Britain proceeded to restore the pound to its prewar parity. The result was unemployment and a general strike which swung the pendulum of public opinion so far in the opposite direction that seven years after the return to parity public opinion was willing to accept, not merely devaluation, but also the abandonment of the gold standard and of free trade, and the adoption of Imperial Preference i.e. all the things Britain had stood against in her modern history. There is a warning in this experience. A new failure of convertibility may not

merely lead to the conclusion that the attempt was premature, it may discredit the idea of international cooperation itself and fan the fires of extreme economic nationalism which, in all countries, are smouldering in the background.